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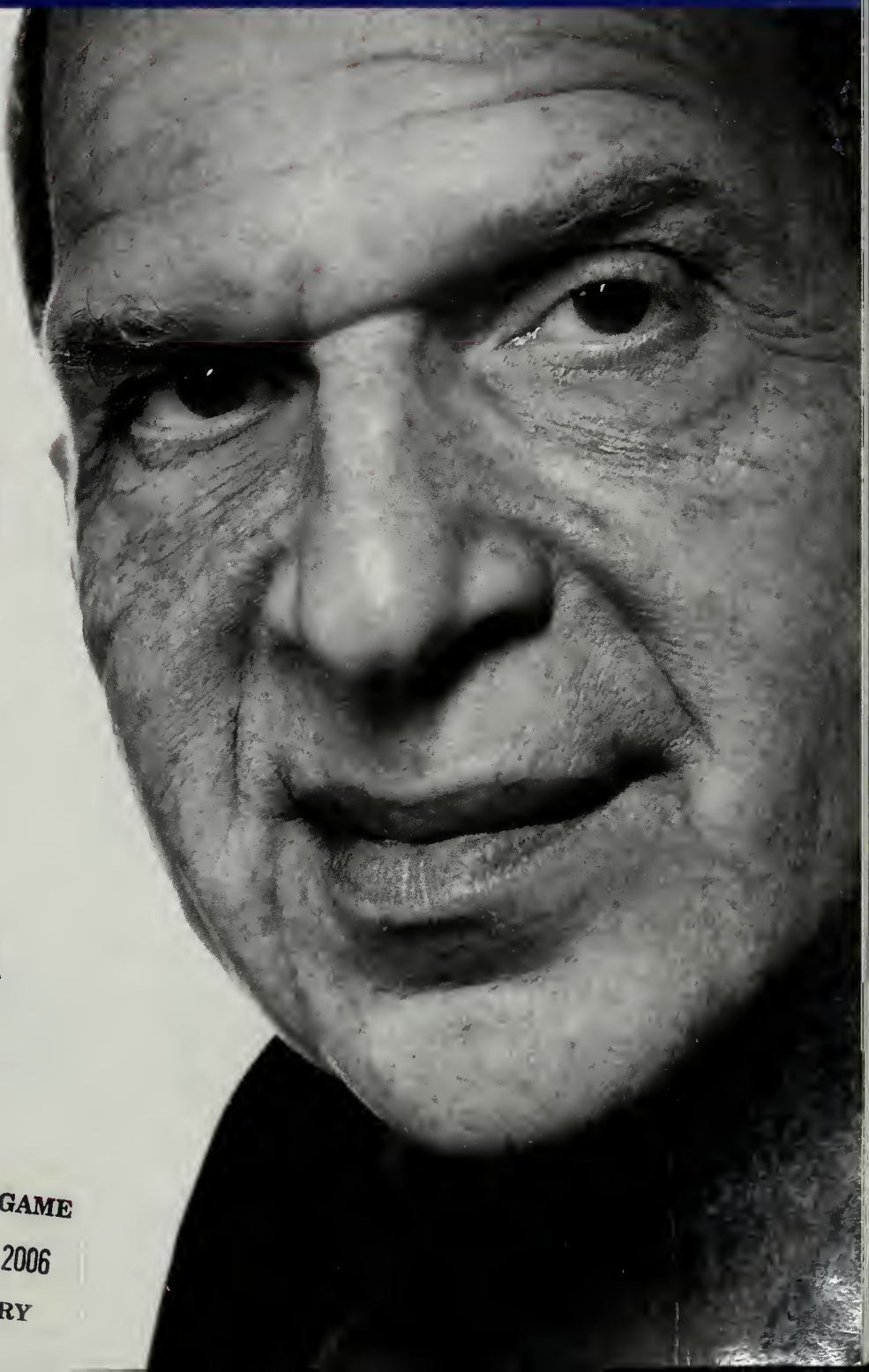
An exclusive account of how BRUCE WASSERSTEIN seized control of Lazard and is remaking the granddaddy of M&A

BY ANTHONY BIANCO (P.54)



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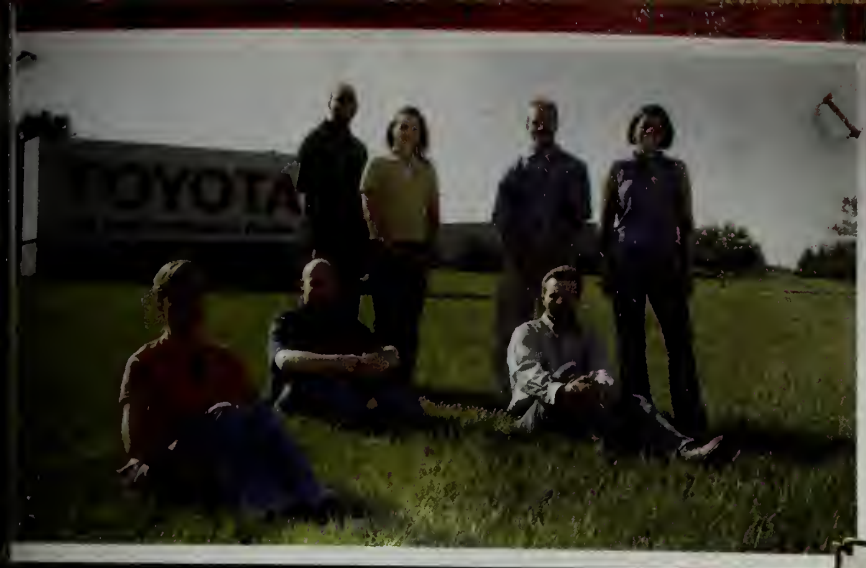

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ews & Insights

Capital One's Credit Trap
offering multiple cards, the lender ps land some borrowers in a deep hole l boosts its earnings with fee income

Timing the Trades?
ne executives appear to be making gains in stock trading plans meant to clude manipulation

The Other Indian Outsourcer
enture and the Umatilla tribes team to help meet demand for low-cost . call centers and document prep

Here Come the Bride Sites
. Internet heavies are tying the t with some of India's fast-growing tchmaking dot-coms

conomics

Sit Tight or Sell?
ew look at booms and busts in the ided housing market

he Corporation

That Hog Has Legs
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at the company should do according those who know its products best

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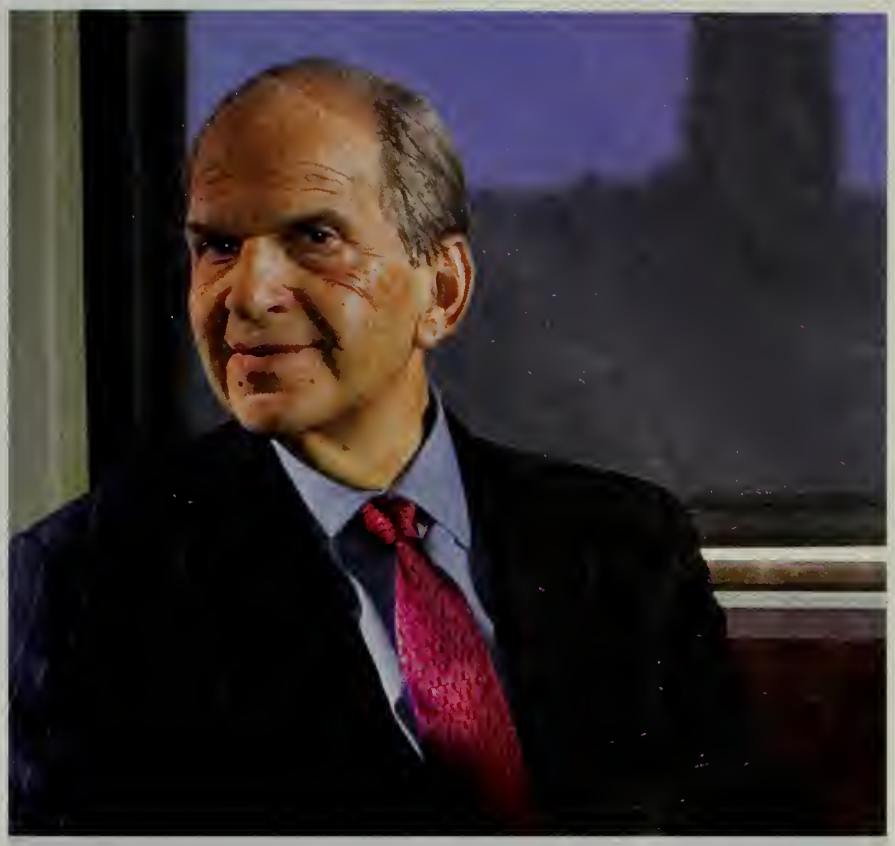

Special Report

54 The Taking of Lazard In a career of great deals, Bruce Wasserstein has pulled off his greatest: the IPO of the storied investment bank. Credit a penchant for bold, attention-grabbing moves and a smart restocking of Lazard's senior ranks. But will Lazard prosper as the merger wave recedes?

62 Very Private Equity Inside Wasserstein & Co., now thriving after a terrible start in the late 1980s

GLOBAL REPORT

44 A Dragon in R&D China's labs may soon rival its powerhouse factories. And multinationals are flocking in for tech innovations—from chips to autos to pharmaceuticals

50 A Growing Cadre of Code Warriors China's young programming hotshots are gaining global attention

52 Intel: Inside China's Internet Cafés The company's local engineers devised a new system for a hopping market

CONTENTS

66 | HOUSING

76 | MARTHA STEWART

98 | FOXHUNTIN

People

76 Martha Stewart, Reinvented
She's focused on rebuilding her brand, but she's learned how to delegate after being forced to give up her board seat

Government

84 More Elbow Room on the Net
A pending upgrade will provide an almost limitless number of addresses

Science & Technology

88 U.S. Biotech Is Feeling Needy
There's a dearth of qualified job seekers because universities aren't teaching the skills companies want

89 Developments to Watch
Snake venom and strep throat; water surveillance; a new encryption device

InfoTech

90 Location, Location, Location
Navteq car navigation systems are stuck in traffic for now but are revving up for a huge potential market

94 Long Arm of the Cell Phone
They're becoming increasingly sophisticated tracking devices popular in social networking circles

Executive Life

98 Foxhunting, but Hold the Fox
Outside Chicago, 70 riders take to a network of forest paths and residential streets in a distinctly American twist on an exhilarating old sport

102 Fine *Fromages* from the Heartland
Wisconsin's artisanal producers are making cheeses that rival Europe's best

104 Spicing Up the Gin Mill
Distillers are adding cinnamon, violets, and saffron, among other flavors

106 A Jaw-Dropping Drop-Top
Mercedes' sleek new retractable-roof SL550 Roadster is a knockout. At $100,000, it should be

108 Jonathan Schwartz: My Tunes
A newly released box set of Frank Sinatra gives you Ol' Blue Eyes live and swinging in Las Vegas

110 Parker on Wine
Walter Hansel Winery offers gorgeous chardonnay and pinot noir at prices that will startle you

Personal Finance

112 Getting Personal with Your Trust
How to keep tabs on your family legacy and make sure your bank is giving you the best possible returns

Columnists

18 Kerry Sulkowicz: Analyze This
Shop talk at home; the barge-in boss

26 Steve Wildstrom: Tech & You
The media-sharing follies

28 Jon Fine: MediaCentric
Why NBC's new script needs a rewrit

29 Jim Cooper: The Business Outloo
Faster growth and unexpected pressi begin to make a rate hike thinkable

114 Gene Marcial: Inside Wall Street

120 Maria Bartiromo: Face Time
The NYSE's John Thain discusses its proposed takeover of Euronext

122 Jack and Suzy Welch: The Welch
A split in leadership can cause divisi

Ideas

118 Books
Luderman and Erlandson: *Alpha M Syndrome*

Features

13 UpFront
20 Readers Report
23 Corrections & Clarifications
116 Figures of the Week
117 Index to Companies

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UP Front

"Even more than turnaround, I would use the word transformation...of the product line...and of the business."

–Recently appointed Ford CEO Alan R. Mulally, discussing the carmaker's worst financial results in over 14 years and what he needs to accomplish

TED BY DEBORAH STEAD

DEOCONFERENCING

Are You Ready For Your Close-Up?

BEING THERE Cisco executives (in separate locations) demonstrate their TelePresence gear

E'S **Cisco Systems** CEO John mbers bragging about his latest ring: "Make no mistake about it; is cool," he says, announcing the pany's new TelePresence Meeting em on Oct. 23. It is cool, agree many lysts and some customers. But not the budget-constrained.

Vith its new meeting technology, co is joining a handful of other panies starting to offer superhigh-lity "telepresence" gear, one of ndom's Holy Grails: eoconference systems intended to ke participants forget they're in erent places. The people captured creen are life-size—and lifelike: s move in perfect sync with the eo. There's eye contact. And no lio lag. (To enhance that feeling of togetherness, each vendor installs conferencing rooms that look alike, with the same tables and wall colors.)

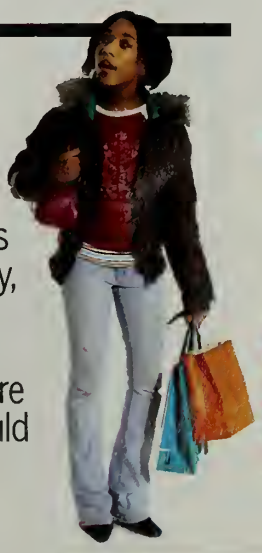
As for the price, brace yourself. **Hewlett-Packard's** Halo system, the priciest, costs $425,000 plus $18,000 a month per conference room for operating costs. **Polycom's** new ultrapremium RPX product goes for $249,000. As for Cisco's, it'll cost as much as $299,000 for the hardware and $3,500 in monthly costs. At those prices, just those with deep pockets are buying. Customers for HP's system include **Novartis** and **PepsiCo.** Banking giant **Wachovia** plans to use Cisco's to let trading managers worldwide share data and strategies. Wachovia senior vice-president George Mattingly calls the technology "revolutionary."

The new systems could provide a bit of an extra boost to the videoconferencing business, expected to rise by an average of 22% a year through 2010 from $1.1 billion now, says researcher **Frost & Sullivan.** But is telepresence worth the bandwidth? Many conventional setups, especially high-def ones, are excellent, says Andrew Davis of **Wainhouse Research.** Some "can provide 95% of the experience of telepresence at 25% of the cost," he says.

Cisco and others hope that the technology will eventually trickle down to uses in hotels, airport lounges, or even doctors' offices. If hardware prices fall far enough, says Chambers, "we can see this in upper-middle-class homes in the next three to five years." Well, maybe his home. *–Louise Lee*

HE BIG PICTURE

IOSE coveted 13-to-25-year-d consumers, part of the -called millennial generation, e fast establishing themselves civic-minded. In a new survey, % said they feel personally sponsible for making a ference in the world. And more an 75% said companies should n them in this effort.



Percentage of 13-to-25-year-olds who say they:

Are likely to switch brands (given equal price and quality) to support a cause	89%
Are more likely to pay attention to messages of companies deeply committed to a cause	74%
Consider a company's social commitment when deciding where to shop	69%
Consider a company's social commitment when recommending products	66%

Data: Cone Inc./AMP Insights, survey of 1,800 13-to-25-year-olds

ADDICTIONS

YOU ARE (HOOKED ON) WHAT YOU EAT

A team of scientists at **Yale University** has discovered that eating sets off the reward center in the brain—the same center activated by other pleasure stimulators, such as sex, cocaine, and alcohol.

Researchers have known for several years that a hormone produced in the gut, ghrelin, triggers the desire to eat. But they didn't know how. By studying rats, the Yale team found that ghrelin causes the brain to produce dopamine, a chemical that induces euphoria.

Dopamine is key to most addictive behaviors. The more we produce, the more we crave. When the researchers infused ghrelin into rats, the rodents increased their food intake. And when the hormone was blocked, they ate less, even after a 24-hour fast.

Lead investigator Tamas Horvath says the discovery means drugs aimed at treating addiction might also work against overeating, and vice versa. His team is now conducting experiments to determine ghrelin's role in cocaine addiction

–Catherine Arnst

NAME GAME

PLEASE DON'T CALL IT AN SUV

IN A SERIES of new TV and print ads for the **BMW** X3 sport-activity vehicle, or SAV, the message is clear. Don't call this car a sport-utility vehicle. In one TV commercial, created by Austin (Tex.)-based **GSD&M**, a driver in a hulking SUV abruptly brakes at an intersection, causing the vehicle's skin to slide off. Left behind: the surprised driver, now sitting in what is revealed to be a pickup truck. "What's hidden inside your SUV?" asks the ad, after which the camera goes to a shot of the nimble X3, which is built on a passenger-car base, not a truck chassis.

Why the emphasis on being not-an-SUV? BMW has long marketed its X3 and X5 vehicles as SAVs. But the acronym has never caught on. Instead, both models are typically called SUVs, a bad label these days, as SUVs fall out of fashion with drivers who bought the gas-guzzlers in the past decade.

BMW marketing manager Patrick McKenna says high gas prices have diminished the appeal of SUVs, even as pump prices are moderating quite a bit. "There are a lot of purchase decisions up in the air right now," he says, "and we have a story to get out." The message to get across, he says, is that "our SAVs perform as well as our cars with added utility."

BMW isn't the only one trying to lose the SUV tag. Last spring, Cadillac was disappointed in sales of its SRX, which had made **Car & Driver's** "Five Best Trucks" list three years running. Th SRX had been informally dubbed a "luxury SUV" by dealers, journalists, and customers. So Caddy bega advertising the vehicle as t "SRX Crossover." Sales ha risen since then, says Cadi global marketing director Vanzura, who credits the r moniker. "If you don't def what you are, someone els will," she says. *–David K*

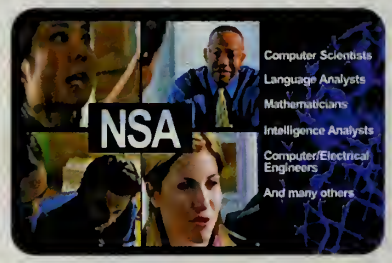
2007 BMW X3

ESPIONAGE

COME SPY WITH ME, COUCH POTATO

IN THE HIT ABC drama *Lost*, a band of castaways goes up against a clandestine, globe-spanning operation. But it's what recently ran during the commercials that's truly wild: the first TV ad for the secretive **National Security Agency.** The recruiting ads ("Where Intelligence Goes to Work") aired for five weeks, until Oct. 15, on TV stations in the Baltimore-Washington area—one of the "fastest-growing high-tech corridor markets," the agency says.

The NSA, which specializes in electronic eavesdropping, is having a tough time finding candidates qualified in computer science, math, and cryptanalysis, or code-breaking. Thus, the 30-second help-wanteds were aimed at those who like puzzles, even fictional on **CBS's** *CSI*, **NBC's** *Law & O* the **Discovery Channel's** *MythBusters*, and *Lost*. "(adversaries do their best keep their plans a secret, the ad's voiceover intone "At the National Security Agency, we uncover thos secrets and keep our ow secrets safe."



NSA Human Resources Director Taflan says that sin start of the campaig produced by **CACI Strategic Communica** nearly 4,000 peopl have visited the agency's jobs site.

–Eamon

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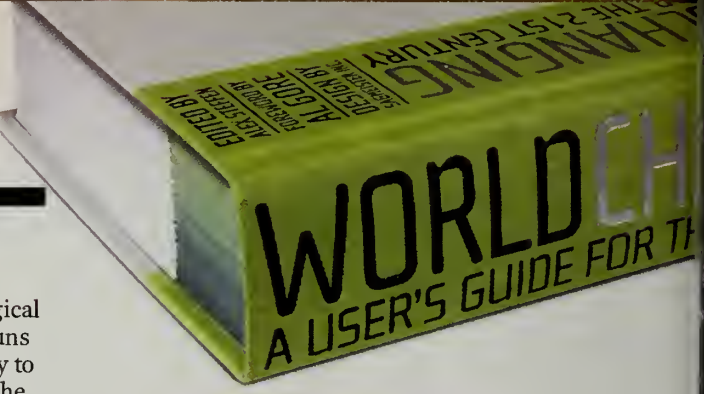
FOR $90,000 a year, you can get an early idea of what the **National Weather Service** will forecast. **WSI,** a corporate cousin to **The Weather Channel** at Landmark Communications, figures energy traders will leap at the chance to know an hour ahead of time what the nation's official forecaster is likely to say about the 6- to 15-day temperature outlook for different U.S. regions. The head start could mean big bucks on days when the official forecast moves natural gas and electricity prices.

As a forecast of a forecast, the WSI MarketFirst service, due to roll out on Oct. 29, uses the same meteorological data as the NWS. It just runs the numbers more quickly to get a rough idea of what the agency will announce. The map it produces shows whether the NWS will lower the forecasted temperature for a region or raise it.

Ira Scharf, WSI vice-president of energy services, says the company's predictions are right about 80% of the time in areas of the U.S. where weather patterns are most predictable at forecast time.

The Andover (Mass.) company, which does conventional forecasting for clients like **American Airlines** and **Goldman Sachs,** isn't the first to try to scoop the official forecast. But, Scharf says, previous attempts fell short. "We think we have gold," he says. *–Peter Coy*



NO TREES WERE HARMED...

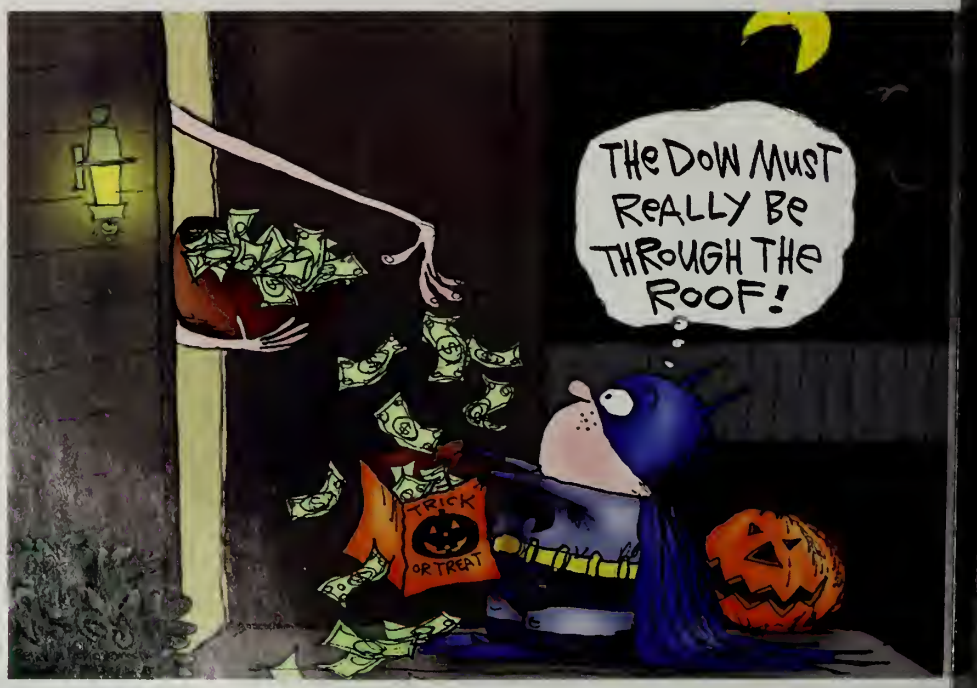
HOW DOES WorldChanging, a nonprofit dedicated to sustainability and social responsibility, print 200,000 copies of a 600-page book and keep its eco-cred? The answer on the last page of the book, *A User's Guide fo the 21st Century*. Publisher Harry N. Abrams, readers learn, bought wind-power credits to offset the energy used to produce the book, made from post-consumer recycled paper (sparing trees and saving water). And to ameliorate the effects of a 14-city book tour, th group is investing in greenhouse gas reductio a move reminiscent of the carbon-neutral effo made by Al Gore (who wrote the foreword) wh he traveled to promote *An Inconvenient Truth*. The book, with its entries on green design anc ethical business, can itself be recycled, of course, though editor Alex Steffen hopes peo "will pass it along instead." *–Elizabeth Wo*

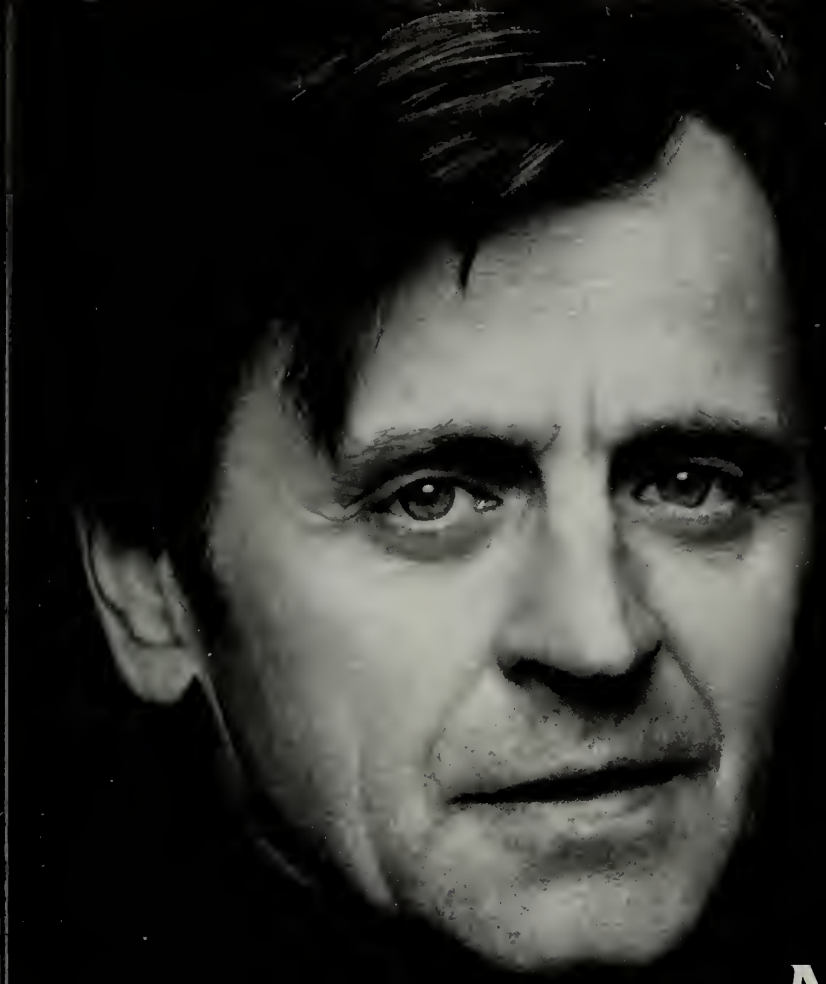
TRENDSPOTTING

THE HIGH COST OF FEAR

» **A NEW SURVEY** on the cost of terrorism indicates that for **S&P 500** companies alone, the threat has brought direct and indirect costs of $107 billion a year. That figure includes extra spending (on insurance and redundant capacity, for instance) and lost revenues (from fearful consumers' decreased activity). Another finding of the September survey of CFOs, conducted by **Duke University's** Fuqua School of Business and *CFO* magazine: Some 21% of U.S. companies have reduced employees' air travel since September 11 (as have 17% of European companies).

–Nanette Byrnes





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ANALYZE THIS BY KERRY SULKOWICZ, M.D.

Talking Shop Till You Drop

When my wife comes home at the end of the day, all she can do is talk about work—the people she's talked to, the office politics, the personalities. It's a major theme throughout the evening. I'm not particularly interested, but I feel I'd be unsupportive if I told her so. She obviously needs an outlet for all this. Should I tell her I don't care? If so, how can I do it delicately?

–J.K., Ridgefield, Conn.

For some people, work is what's most fulfilling, and part of their pleasure comes from sharing it with a loved one. That's O.K. up to a point. Perhaps you're the only one she can do that with, so within reason it's a form of intimacy. (Indeed, for most couples, the absence of any conversation about work would be problematic.) But when it's consuming, when talk about work takes up a big chunk of private life, the spouse who's the sounding board can feel neglected. It might be useful to think about whether you're giving her any reason to distance herself from you. Is it possible that she's investing all that emotional energy in work as a way of avoiding something closer with you? The subtext of her monologues could be that she's not getting enough from you.

You're right that telling her you don't care would hurt her. It would also shut off more of the kind of communication you want. How about picking a moment to say something like, "I know you've got a lot going on at work, and it's great that you care so much about it, but I'm starting to feel left out. I want to hear about it, but anything I want to say about me, or us, just feels like an interruption." That's the gist of what I'd try to convey. But don't take it as a script. It should sound like you.

My boss feels free to come into my office without regard to what I'm doing. She doesn't knock or say anything more than a cursory "excuse me" and then interrupts me. Or she says, "Are you busy?" and proceeds before can answer her. I find this disruptive, annoying, and disrespectful. How can I tell her stop, or is this something I just h to live with?

–L.M.K., Groton, C

There's a power differential betwee you and your boss, of course, and i quite understandable that this inhi you. But if you just suffer in silence you're abetting the bad behavior. You're al more likely to respond in a passive-aggre or some other indirect way that could hur you and your professional reputation. Try explaining to her that while you like the fa that she feels comfortable in approachin informally, a lot of unannounced visits get the way of your performance. Then perha suggest a plan for checking in regularly w each other throughout the day.

Kerry J. Sulkowicz, M.D., a psychoanalyst a founder of the Boswell Group, advises exec on psychological aspects of business. Send questions at analyzethis@businessweek.co

QUESTION OF THE WEEK

On Oct. 19, a New York Judge ordered Richard Grasso to give back up to $95 million of the $187.5 million he was paid as chairman and CEO of the New York Stock Exchange. How will this reverberate in C-suites and boardrooms?

–Jim Taibi

"The important part of the ruling is what it says to directors. It's a wake-up call that they have to do the math [on CEO pay packages], ask tough questions. And more important, give tough answers—like 'No, that's too much.'" *Nell Minow, co-founder and editor, The Corporate Library*

"I feel sorry for Dick. He did a good job. But that money was egregious. You don't join a not-for-profit and expect to be paid like that. Did the compensation committee do their homework?" *Muriel Siebert, first female member, NYSE; former N.Y. State Banking Superintendent; president, Muriel Siebert & Co.*

"The precedent-setting issue here: a CEO's duty to inform the board fully about his or her pay and th board's duty to learn those details. Pay formulas are s complex today that even sophisticated directors can't figure out the bottom line." *H. Rodgin Coh chairman, Sullivan & Crom*

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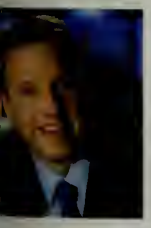

We know we don't control the price of gas, but we can innovate to reduce the need. That's why we're building cars that can go 500 miles on a single tank and producing 250,000 E-85 ethanol vehicles this year. We even have 12 vehicles that get 30 mpg or more.* At Ford, innovation is the guiding compass of everything we do.

Bill Ford, Executive Chairman
Ford Motor Company

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"The potential of organic to transform agriculture and improve the health of the planet is no myth...."

–Gary Hirshberg
Londonderry, N.H.

WEIGHING IN ON THE GROWTH OF ORGANICS

MUCH AS WE APPLAUD many aspects of Diane Brady's examination of the organics industry ("The organic myth," Cover Story, Oct. 16), we at Stonyfield Farm take exception to the cover image and text as well as the title of the story, all of which we found misleading.

The organics "myth"? The organics industry is "failing to stay true to its ideals"? Hardly. As Brady explains, Stonyfield Farm and other companies are spending considerable time and money sourcing now-scarce organic products, supporting family farms by paying premium prices, and helping farmers financially as they convert from conventional to organic.

Neglected in the story was the fact that our organic milk comes from our partnership with Organic Valley Family of Farms CROPP Cooperative, a dairy cooperative of more than 600 family farmers—zero factory farms.

We source more than 160 million pounds of organic ingredients annually: fruit sweeteners, milk, grains, spices, etc., which support more than 40,000 acres of organic production. Also absent from the story was the fact that some ingredients, like organic cocoa, banana, and van can't be grown in the U.S., so we im them, while our imports of organic in dients that could be grown in the make up less than 2% of our organic gredient purchases.

Stonyfield Farm has been one of nation's leading advocates of fa farms in the U.S. for more than decades. We spend millions of do each year investing in farmers conver to organic, sponsoring training w shops and other programs, and pa premiums to farmers to produce org milk and other ingredients.

The potential of organic to transf agriculture and improve the health o planet is no myth at Stonyfield Farm a daily reality.

–Gary Hirsh
President and
Stonyfield F
Londonderry,

YOUR ARTICLE was incorrect in its scriptions of "confined" organic cow those that are "free to roam." Durin coldest half of the year, and indeed round, cows at Aurora Organic F farms roam free in fresh air and shine, while most cows in New Eng

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Is your cholesterol out of whack?

CRESTOR can get your bad cholesterol down. It can also get your good cholesterol up.

High blood pressure and diabetes are among factors that make it even more important to get your bad cholesterol low. But to get your cholesterol right, your doctor may also want your good cholesterol up. And diet and exercise alone may not be enough to lower the bad cholesterol and raise the good.

CRESTOR is a cholesterol medicine that does both.

A 10-mg dose of CRESTOR® (rosuvastatin calcium) along with diet, can lower bad cholesterol, LDL, by up to 52% (vs 7% with placebo). CRESTOR can also raise good cholesterol, HDL, by up to 14% (vs 3% with placebo). Your results may vary.

Down with the bad Up with the good

Is CRESTOR right for you? That's a conversation you need to have with your doctor.

Important safety information about CRESTOR:

CRESTOR is prescribed along with diet for lowering high cholesterol and has not been determined to prevent heart disease, heart attacks, or strokes. CRESTOR is not right for everyone, including women who are nursing, pregnant, or who may become pregnant, or anyone with liver problems. Your doctor will do blood tests before and during treatment with CRESTOR to monitor your liver function. Unexplained muscle pain and weakness could be a sign of a rare but serious side effect and should be reported to your doctor right away. The 40-mg dose of CRESTOR is only for patients who do not reach goal on 20 mg. Be sure to tell your doctor if you are taking any medications. Side effects occur infrequently and include muscle aches, constipation, weakness, abdominal pain, and nausea. They are usually mild and tend to go away.

Please read the important Product Information about CRESTOR on the adjacent page.

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Please read this summary carefully and then ask your doctor about CRESTOR. No advertisement can provide all the information needed to determine if a drug is right for you. This advertisement does not take the place of careful discussions with your doctor. Only your doctor has the training to weigh the risks and benefits of a prescription drug.

BRIEF SUMMARY: For full Prescribing Information, see package insert. **INDICATIONS AND USAGE** CRESTOR is indicated: 1. as an adjunct to diet to reduce elevated total-C, LOL-C, ApoB, nonHOL-C, and TG levels and to increase HDL-C in patients with primary hypercholesterolemia (heterozygous familial and nonfamilial) and mixed dyslipidemia (Fredrickson Type IIa and IIb); 2. as an adjunct to diet for the treatment of patients with elevated serum TG levels (Fredrickson Type IV); 3. to reduce LDL-C, total-C, and ApoB in patients with homozygous familial hypercholesterolemia as an adjunct to other lipid-lowering treatments (e.g., LOL apheresis) or if such treatments are unavailable. **CONTRAINDICATIONS** CRESTOR is contraindicated in patients with a known hypersensitivity to any component of this product. Rosuvastatin is contraindicated in patients with active liver disease or with unexplained persistent elevations of serum transaminases (see WARNINGS, Liver Enzymes). **Pregnancy and Lactation** Atherosclerosis is a chronic process and discontinuation of lipid-lowering drugs during pregnancy should have little impact on the outcome of long-term therapy of primary hypercholesterolemia. Cholesterol and other products of cholesterol biosynthesis are essential components for fetal development (including synthesis of steroids and cell membranes). Since HMG-CoA reductase inhibitors decrease cholesterol synthesis and possibly the synthesis of other biologically active substances derived from cholesterol, they may cause fetal harm when administered to pregnant women. Therefore, HMG-CoA reductase inhibitors are contraindicated during pregnancy and in nursing mothers. ROSUVASTATIN SHOULO BE ADMINISTEREO TO WOMEN OF CHILOBEARING AGE ONLY WHEN SUCH PATIENTS ARE HIGHLY UNLIKELY TO CONCEIVE ANO HAVE BEEN INFORMEO OF THE POTENTIAL HAZAROS. If the patient becomes pregnant while taking this drug, therapy should be discontinued immediately and the patient apprised of the potential hazard to the fetus. **WARNINGS Liver Enzymes** HMG-CoA reductase inhibitors, like some other lipid-lowering therapies, have been associated with biochemical abnormalities of liver function. The incidence of persistent elevations (>3 times the upper limit of normal [ULN] occurring on 2 or more consecutive occasions) in serum transaminases in fixed dose studies was 0.4, 0, 0, and 0.1% in patients who received rosuvastatin 5, 10, 20, and 40 mg, respectively. In most cases, the elevations were transient and resolved or improved on continued therapy or after a brief interruption in therapy. There were two cases of jaundice, for which a relationship to rosuvastatin therapy could not be determined, which resolved after discontinuation of therapy. There were no cases of liver failure or irreversible liver disease in these trials. **It is recommended that liver function tests be performed before and at 12 weeks following both the initiation of therapy and any elevation of dose, and periodically (e.g., semiannually) thereafter.** Liver enzyme changes generally occur in the first 3 months of treatment with rosuvastatin. Patients who develop increased transaminase levels should be monitored until the abnormalities have resolved. Should an increase in ALT or AST of >3 times ULN persist, reduction of dose or withdrawal of rosuvastatin is recommended. Rosuvastatin should be used with caution in patients who consume substantial quantities of alcohol and/or have a history of liver disease (see CLINICAL PHARMACOLOGY, Special Populations, Hepatic Insufficiency). Active liver disease or unexplained persistent transaminase elevations are contraindications to the use of rosuvastatin (see CONTRAINOICATIONS) **Myopathy/Rhabdomyolysis Rare cases of rhabdomyolysis with acute renal failure secondary to myoglobinuria have been reported with rosuvastatin and with other drugs in this class.** Uncomplicated myalgia has been reported in rosuvastatin-treated patients (see AOVERSE REACTIONS). Creatine kinase (CK) elevations (>10 times upper limit of normal) occurred in 0.2% to 0.4% of patients taking rosuvastatin at doses up to 40 mg in clinical studies. Treatment-related myopathy, defined as muscle aches or muscle weakness in conjunction with increases in CK values >10 times upper limit of normal, was reported in up to 0.1% of patients taking rosuvastatin doses ot up to 40 mg in clinical studies. In clinical trials, the incidence of myopathy and rhabdomyolysis increased at doses of rosuvastatin above the recommended dosage range (5 to 40 mg). In postmarketing experience, effects on skeletal muscle, e.g. uncomplicated myalgia, myopathy and, rarely, rhabdomyolysis have been reported in patients treated with HMG-CoA reductase inhibitors including rosuvastatin. As with other HMG-CoA reductase inhibitors, reports of rhabdomyolysis with rosuvastatin are rare, but higher at the highest markeled dose (40 mg). Factors that may predispose patients to myopathy with HMG-CoA reductase inhibitors include advanced age (≥65 years), hypothyroidism, and renal insufficiency. Consequently: 1. Rosuvastatin should be prescribed with caution in patients with predisposing factors for myopathy, such as, renal impairment (see OOSAGE ANO AOMINISTRATION), advanced age, and inadequately treated hypothyroidism. 2. Patients should be advised to promptly report unexplained muscle pain, tenderness, or weakness, particularly it accompanied by malaise or fever. Rosuvastatin therapy should be discontinued if markedly elevated CK levels occur or myopathy is diagnosed or suspected. 3. The 40 mg dose ot rosuvastatin is reserved only for those patients who have not achieved their LOL-C goal utilizing the 20 mg dose of rosuvastatin once daily (see OOSAGE ANO AOMINISTRATION) 4 The risk of myopathy during treatment with rosuvastatin may be increased with concurrent administration of other lipid-lowering therapies or cyclosporine, (see CLINICAL PHARMACOLOGY, Orug Interactions, PRECAUTIONS, Drug Interactions, and OOSAGE ANO AOMINISTRATION). **The benefit of further alterations in lipid levels by the combined use of rosuvastatin with fibrates or niacin should be carefully weighed against the potential risks of this combination. Combination therapy with rosuvastatin and gemfibrozil should generally be avoided. (See OOSAGE ANO ADMINISTRATION and PRECAUTIONS, Orug Interactions).** 5 **The risk of myopathy during treatment with rosuvastatin may be increased in circumstances which increase rosuvastatin drug levels (see CLINICAL PHARMACOLOGY, Special Populations, Race and Renal Insufficiency, and PRECAUTIONS, General).** 6. **Rosuvastatin therapy should also be temporarily withheld in any patient with an acute, serious condition suggestive of myopathy or predisposing to the development of renal failure secondary to rhabdomyolysis (e.g., sepsis, hypotension, dehydration, major surgery, trauma, severe metabolic, endocrine, and electrotyte disorders, or uncontrolled seizures).** **PRECAUTIONS General** Before instituting therapy with rosuvastatin, an attempt should be made to control hypercholesterolemia with appropriate diet and exercise, weight reduction in obese patients, and treatment of underlying medical problems (see INDICATIONS AND USAGE). Administration of rosuvastatin 20 mg to patients with severe renal impairment (Cl_{cr} <30 mL/min/1.73 m^2) resulted in a 3-fold increase in plasma concentrations of rosuvastatin compared with healthy volunteers (see WARNINGS, Myopathy/Rhabdomyolysis and OOSAGE ANO ADMINISTRATION). The result of a large pharmacokinetic study conducted in the US demonstrated an approximate 2-fold elevation in median exposure in Asian subjects (having either Filipino, Chinese, Japanese, Korean, Vietnamese or Asian-Indian origin) compared with a Caucasian control group. This increase should be considered when making rosuvastatin dosing decisions for Asian patients. (See WARNINGS, Myopathy/Rhabdomyolysis; CLINICAL PHARMACOLOGY, Special Populations, Race, and DOSAGE ANO AOMINISTRATION.) **Infarmatian far Patients** Patients should be advised to report promptly unexplained muscle pain, tenderness, or weakness, particularly if accompanied by malaise or fever. When taking rosuvastatin with an aluminum and magnesium hydroxide combination antacid, the antacid should be taken at least 2 hours after rosuvastatin administration (see CLINICAL PHARMACOLOGY, Orug Interactions). **Laboratory Tests** In the rosuvastatin clinical trial program, dipstick-positive proteinuria and microscopic hematuria were observed among rosuvastatin-treated patients, predominantly in patients dosed above the recommended dose range (i.e., 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, when compared to lower doses of rosuvastatin or comparator statins, though it was generally transient and was not associated with worsening renal function. Although the clinical significance of this finding is unknown, a dose reduction should be considered for patients on rosuvastatin 40 mg therapy with unexplained persistent proteinuria during routine urinalysis testing. **Drug Interactions Cyclosporine:** When rosuvastatin 10 mg was coadministered with cyclosporine in cardiac transplant patients, rosuvastatin mean C_{max} and mean AUC were increased 11-fold and 7-fold, respectively, compared with healthy volunteers. These increases are considered to be clinically significant and require special consideration in the dosing ot rosuvastatin to patients taking concomitant cyclosporine (see WARNINGS, Myopathy/Rhabdomyolysis, and DOSAGE ANO AOMINISTRATION). **Warfarin:** Coadministration of rosuvastatin to patients on stable warfarin therapy resulted in clinically significant rises in INR (>4, baseline 2-3). In patients taking coumarin anticoagulants and rosuvastatin concomitantly, INR should be determined before starting rosuvastatin and frequently enough during early therapy to ensure that no significant alteration of INR occurs. Once a stable INR time has been documented, INR can be monitored at the intervals usually recommended for patients on coumarin anticoagulants. If the dose ot rosuvastatin is changed, the same procedure should be repeated. Rosuvastatin therapy has not been associated with bleeding or with changes in INR in patients not taking anticoagulants. **Gemtibrozil:** Coadministration of a single rosuvastatin dose to healthy volunteers on gemtibrozil (600 mg twice daily) resulted in a 2.2- and 1.9-fold, respectively, increase in mean C_{max} and mean AUC of rosuvastatin (see OOSAGE ANO AOMINISTRATION). **Endocrine Functian** Although clinical studies have shown that rosuvastatin alone does not reduce basal plasma cortisol concentration or impair adrenal reserve, caution should be exercised if any HMG-CoA reductase inhibitor or other agent used to lower cholesterol levels is administered concomitantly with drugs that may decrease the levels or activity of endogenous steroid hormones such as ketoconazole, spironolactone, and cimetidine **CNS Taxicity** CNS vascular lesions, characterized by pervascular hemorrhages, edema, and mononuclear cell infiltration ot perivascular spaces, have been observed in dogs treated with several other members of this drug class. A chemically similar drug in this class produced dose-dependent optic nerve degeneration (Wallerian degeneration ot retinogeniculate fibers) in dogs, at a dose that produced plasma drug levels about 30 times higher than the mean drug level in humans taking the highest recommended dose. Edema, hemorrhage, and partial necrosis in the interstitium of the choroid plexus was observed in a female dog sacrificed moribund at day 24 at 90 mg/kg/day by oral gavage (systemic exposures 100 times the human exposure at 40 mg/day based on AUC comparisons). Corneal opacity was seen in dogs treated for 52 weeks at 6 mg/kg/day by oral gavage (systemic exposures 20 times the human exposure at 40 mg/day based on AUC comparisons). Cataracts were seen in dogs treated for 12 weeks by oral gavage at 30 mg/kg/day (systemic exposures 60 times the human exposure at 40 mg/day based on AUC comparisons). Retinal dysplasia and retinal loss were seen in dogs treated for 4 weeks by oral gavage at 90 mg/kg/day (systemic exposures 100 times the human exposure at 40 mg/day based on AUC). Ooses ≤30 mg/kg/day (systemic exposures ≤60 times the human exposure at 40 mg/day based on AUC comparisons) following treatment up to one year, did not reveal retinal findings. **Carcinogenesis, Mutagenesis, Impairment of Fertility** In a 104-week carcinogenicity study in rats at dose levels of 2, 20, 60, or 80 mg/kg/day by oral gavage, the incidence ot uterine stromal polyps was significantly increased in females at

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rosuvastatin calcium

80 mg/kg/day at systemic exposure 20 times the human exposure at 40 mg/day based on AUC. Increased incidence ot polyps was not seen at lower doses. In a 107-week carcinogenicity study in mice given 10, 60, 200 mg/kg/day by oral gavage, an increased incidence of hepatocellular adenoma/carcinoma was observed at 200 mg/kg/day at systemic exposures 20 times human exposure at 40 mg/day based on AUC. An increased incidence of hepatocellular tumors was not seen at lower doses. Rosuvastatin was not mutagenic or clastogenic with or without metabolic activation in the Ames test with *Salmonella typhimurium* and *Escherichia coli*, the mouse lymphoma assay, and the chromosomal aberration assay in Chinese hamster lung cells. Rosuvastatin was negative in the *in vivo* mouse micronucleus test. In rat fertility studies with oral gavage doses of 5, 15, 50 mg/kg/day, males were treated for 9 weeks prior to and throughout mating and females were treated 2 weeks prior to mating and throughout mating until gestation day 7. No adverse effect on fertility was observed at 50 mg/kg/day (systemic exposures up to 10 times human exposure at 40 mg/day based on AUC comparisons). In testicles of dogs treated with rosuvastatin at 30 mg/kg/day for one month, spermatidic giant cells were seen. Spermatidic giant cells were observed in monkeys after 6-month treatment at 30 mg/kg/day in addition to vacuolation of seminiferous tubular epithelium. Exposures in the dog were 20 times and in the monkey 10 times human exposure at 40 mg/day based on body surface area comparisons. Similar findings have been seen with other drugs in this class. **Pregnancy** ***Pregnancy Category X*** See CONTRAINDICATIONS. Rosuvastatin may cause fetal harm when administered to a pregnant woman. Rosuvastatin is contraindicated in women who are or may become pregnant. Safety in pregnant women has not been established. There are no adequate and well-controlled studies of rosuvastatin in pregnant women. Rosuvastatin crosses the placenta and is found in fetal tissue and amniotic fluid at 3% and 20%, respectively, of the maternal plasma concentration following a single 25 mg/kg oral gavage dose on gestation day 16 in rats. A higher fetal tissue distribution (25% maternal plasma concentration) was observed in rabbits after a single oral gavage dose ot 1 mg/kg on gestation day 18. If this drug is administered to a woman with reproductive potential, the patient should be apprised ot the potential hazard to a fetus. In female rats given oral gavage doses of 5, 15, 50 mg/kg/day rosuvastatin before mating and continuing through day 7 postcoitus results in decreased fetal body weight (female pups) and delayed ossification at the high dose (systemic exposures 10 times human exposure at 40 mg/day based on AUC comparisons). In pregnant rats given oral gavage doses of 2, 20, 50 mg/kg/day from gestation day 7 through lactation day 21 (weaning), decreased pup survival occurred in groups given 50 mg/kg/day, systemic exposures ≥12 times human exposure at 40 mg/day based on body surface area comparisons. In pregnant rabbits given oral gavage doses of 0.3, 1, 3 mg/kg/day from gestation day 6 to lactation day 18 (weaning), exposures equivalent to human exposure at 40 mg/day based on body surface area comparisons, decreased fetal viability and maternal mortality was observed. Rosuvastatin was not teratogenic in rats at ≤25 mg/kg/day or in rabbits ≤3 mg/kg/day (systemic exposures equivalent to human exposure at 40 mg/day based on AUC or body surface comparison, respectively). **Nursing Mathers** It is not known whether rosuvastatin is excreted in human milk. Studies in lactating rats have demonstrated that rosuvastatin is secreted into breast milk at levels 3 times higher than that obtained in the plasma following oral gavage dosing. Because many drugs are excreted in human milk and because ot the potential for serious adverse reactions in nursing infants from rosuvastatin, a decision should be made whether to discontinue nursing or administration of rosuvastatin taking into account the importance of the drug to the lactating woman. **Pediatric Use** The safety and effectiveness in pediatric patients have not been established. Treatment experience with rosuvastatin in a pediatric population is limited to 8 patients with homozygous FH. None of these patients was below 8 years of age. **Geriatric Use** Of the 10,275 patients in clinical studies with rosuvastatin, 3,159 (31%) were 65 years and older, and 698 (6.8%) were 75 years and older. The overall frequency ot adverse events and types of adverse events were similar in patients above and below 65 years ot age. (See WARNINGS, Myopathy/Rhabdomyolysis.) The efficacy of rosuvastatin in the geriatric population (≥65 years of age) was comparable to the efficacy observed in the non-elderly. **ADVERSE REACTIONS** Rosuvastatin is generally well tolerated. Adverse reactions have usually been mild and transient. In clinical studies ot 10,275 patients, 3.7% were discontinued due to adverse experiences attributable to rosuvastatin. The most frequent adverse events thought to be related to rosuvastatin were myalgia, constipation, asthenia, abdominal pain, and nausea. **Clinical Adverse Experiences** Adverse experiences, regardless of causality assessment, reported in ≥2% of patients in placebo-controlled clinical studies of rosuvastatin are shown in Table 1; discontinuations due to adverse events in these studies of up to 12 weeks duration occurred in 3% of patients on rosuvastatin and 5% on placebo.

Table 1. Adverse Events in Placebo-Controlled Studies

Adverse event	Rosuvastatin N=744	Placebo N=382
Pharyngitis	9.0	7.6
Headache	5.5	5.0
Diarrhea	3.4	2.9
Dyspepsia	3.4	3.1
Nausea	3.4	3.1
Myalgia	2.8	1.3
Asthenia	2.7	2.6
Back pain	2.6	2.4
Flu syndrome	2.3	1.8
Urinary tract infection	2.3	1.6
Rhinitis	2.2	2.1
Sinusitis	2.0	1.8

In addition, the following adverse events were reported, regardless of causality assessment ≥1% of 10,275 patients treated with rosuvastatin in clinical studies. The events in *italics* occu in ≥2% of these patients. **Body as a Whole:** *Abdominal pain, accidental injury, chest pain, in tion, pain*, pelvic pain, and neck pain. **Cardiovascular System:** *Hypertension*, angina pect vasodilatation, and palpitation. **Digestive System:** *Constipation, gastroenteritis*, vomiting, f lence, periodontal abscess, and gastritis. **Endocrine:** Diabetes mellitus. **Hemic and Lymp System:** Anemia and ecchymosis. **Metabolic and Nutritional Disorders:** *Peripheral ede* **Musculoskeletal System:** *Arthritis, arthralgia*, and pathological fracture. **Nervous Sys** *Dizziness, insomnia, hypertonia, paresthesia, depression*, anxiety, vertigo, and neura **Respiratory System:** *Bronchitis, cough increased*, dyspnea, pneumonia, and asthma. **Skin Appendages:** *Rash* and pruritus. **Laboratory Abnormalities:** In the rosuvastatin clinical program, dipstick-positive proteinuria and microscopic hematuria were observed among ros statin-treated patients, predominantly in patients dosed above the recommended dose range 80 mg). However, this finding was more frequent in patients taking rosuvastatin 40 mg, compared to lower doses ot rosuvastatin or comparator statins, though it was generally tran and was not associated with worsening renal function. (See PRECAUTIONS, Laboratory Te Other abnormal laboratory values reported were elevated creatinine phosphokinase, trans nases, hyperglycemia, glutamyl transpeptidase, alkaline phosphatase, bilirubin, and th function abnormalities. Other adverse events reported less frequently than 1% in the rosuva clinical study program, regardless of causality assessment, included arrhythmia, hepatitis, h sensitivity reactions (i.e., face edema, thrombocytopenia, leukopenia, vesiculobullous urticaria, and angioedema), kidney failure, syncope, myasthenia, myositis, pancreatitis, phot sitivity reaction, myopathy, and rhabdomyolysis. **Pastmarketing Experience** In ad to the events reported above, as with other drugs in this class, the following event has reported during post-marketing experience with CRESTOR, regardless ot causality assess very rare cases of jaundice. **OVERDOSAGE** There is no specific treatment in the ev overdose. In the event of overdose, the patient should be treated symptomatically and supp measures instituted as required. Hemodialysis does not significantly enhance clearance of ro statin. **DOSAGE AND ADMINISTRATION** The patient should be placed on a sta cholesterol-lowering diet before receiving CRESTOR and should continue on this diet during ment. CRESTOR can be administered as a single dose at any time of day, with or without **Hypercholesterolemia (Heterazygaus Familial and Nanfamilial)** **Mixed Dyslipidemia (Fredrickson Type IIa and IIb)** The dose range tor CRE is 5 to 40 mg once daily. Therapy with CRESTOR should be individualized according to g therapy and response. The usual recommended starting dose of CRESTOR is 10 mg once However, initiation of therapy with 5 mg once daily should be considered for patients requirir aggressive LOL-C reductions, who have predisposing factors for myopathy, and as noted bel special populations such as patients taking cyclosporine, Asian patients, and patients with renal insufficiency (see CLINICAL PHARMACOLOGY, Race, and Renal Insufficiency, and Interactions. For patients with marked hypercholesterolemia (LOL-C >190 mg/dL) and agg lipid targets, a 20-mg starting dose may be considered. Affer initiation and/or upon titra CRESTOR, lipid levels should be analyzed within 2 to 4 weeks and dosage adjusted accor **The 40-mg dose ot CRESTOR is reserved only for those patients who have not achieve LOL-C goal utilizing the 20 mg dose of CRESTOR once daily (see WARNINGS, Myo Rhabdomyolysis). When initiating statin therapy or switching from another statin thera appropriate CRESTOR starting dose should first be utilized, and only then titrated accor the patient's individualized goal ot therapy.** **Hamazygaus Familial Hype lesteralemia** The recommended starting dose ot CRESTOR is 20 mg once daily in p with homozygous FH. The maximum recommended daily dose is 40 mg. CRESTOR should t in these patients as an adjunct to other lipid-lowering treatments (e.g., LOL apheresis) or treatments are unavailable. Response to therapy should be estimated from pre-apheresis levels. **Dasage in Asian Patients** Initiation ot CRESTOR therapy with 5 mg on should be considered for Asian patients. The potential for increased systemic exposures rel Caucasians is relevant when considering escalation of dose in cases where hypercholeste is not adequately controlled at doses of 5, 10, or 20 mg once daily. (See WAR Myopathy/Rhabdomyolysis, CLINICAL PHARMACOLOGY, Special Populations, Race PRECAUTIONS, General). **Dasage in Patients Taking Cyclasparine** In patient cyclosporine, therapy should be limited to CRESTOR 5 mg once daily (see WAR Myopathy/Rhabdomyolysis, and PRECAUTIONS, Orug Interactions). **Cancamitant Lawering Therapy** The effect of CRESTOR on LOL-C and total-C may be enhance used in combination with a bile acid binding resin. It CRESTOR is used in combinati gemfibrozil, the dose of CRESTOR should be limited to 10 mg once daily (see WAR Myopathy/Rhabdomyolysis, and PRECAUTIONS, Orug Interactions). **Dasage in Pa With Renal Insufficiency** No modification ot dosage is necessary for patients with moderate renal insufficiency. For patients with severe renal impairment (Cl_{cr} <30 1.73 m^2) not on hemodialysis, dosing of CRESTOR should be started at 5 mg once daily ar exceed 10 mg once daily (see PRECAUTIONS, General, and CLINICAL PHARMACOLOGY, Populations, Renal Insufficiency).

NOTE: This summary provides important information about CRESTOR. For more intor please ask your doctor or health care professional about the full Prescribing Informa discuss it with them.

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the winter are confined in barns. Additionally, you were wrong to use word "failure" to describe the en-ıraging growth of the organic move-nt. The insinuation that the "ideals" of anic have been compromised com-tely ignores the evolution and im-vement of the movement over time. author's view of organic ideals seems come from a moldering copy of the ole Earth Catalog, circa 1968.

We are also disappointed that the au-r chose to rehash the negative rhetoric a few fringe activists instead of cele-ting the great contribution that or-nic has made to America's food supply l environment.

Finally, the author's use of the term "or-nic myth" is not only false but is an in-t to the hard-working, visionary people o are building the organic movement.

We believe all certified organic farms, npanies, and their leaders should be neld and supported, not inaccurately paraged and sensationalized.

–Marc Peperzak, CEO
Mark Retzloff, President
Aurora Organic Dairy
Boulder, Colo.

IS TRUE that demand for organic milk l other foods is growing faster than sup-. Shortages of many organic ingredients increasing prices and our reliance on ports and invite the attention of entre-neurs and growth-oriented companies. t to suggest that as a result the entire or-nic food industry rests on a myth is iculous and unfair. Imagine how differ-the average business story in your gazine would be if this same logic were plied to other sectors of the economy.

Increasing U.S. production of organic ds and animal products is the long-m solution to today's shortages. Cur-ntly, farm policies designed to solve -WWII problems and practical hurdles ing farmers thinking of adopting or-nic farming are holding back the tran-on of farmland to organic production. e forthcoming farm bill should focus overcoming these constraints as one y to more effectively assure food safety d security for consumers and more and ter jobs all along the food chain.

–Dr. Charles Benbrook
Chief Scientist
The Organic Center
Troy, Ore.

IE ONE MISSING element in your oth-vise impressive and comprehensive ry was a lack of emphasis on the fact t the vast majority of all dairy products in this country, like many other organic categories, are produced by businesses of high ethical integrity.

A comprehensive report that rated the country's 70 organic dairy brands, posted on www.cornucopia.org, indicates that approximately 90% rely exclusively on family farms, not on the large industrial feedlot dairies profiled in your story.

Dean Foods Co.'s Horizon Organic milk may be the largest player in the market, but it would be a grave disservice to all the hard-working family farmers in the country if consumers conclude that Horizon's 8,000-cow operation in the Idaho desert has become the standard for organic production.

–Mark Alan Kastel
The Cornucopia Institute
Cornucopia, Wis.

AS AN ORGANIC FARMER, it is difficult for me to see the words "The Organic Myth" on the cover of a national magazine. However, organic farmers are not in denial that industrial agriculture is doing everything it can to put industry into the regulatory definition of organic agriculture.

The side of the story you missed, though, is that organic agriculture has the potential to meet the demands of the future. We are now paying the price for the U.S. Agriculture Dept. not promoting organic practices in the 1970s, when farmers were instead told to plant "fence row to fence row." If 36 years of federal research and support had been thrown behind organic agriculture, we would all be healthier right now, and supply would more than meet demand.

–Tom Ruggieri
Fair Share Farm
Kearney, Mo.

WHAT 'BIG DADDY' WEILL COULD TEACH TODAY'S CEOs

I WORKED ON AND OFF for Sandy Weill beginning in 1974 until his retirement ("Self-portrait, ego included," Books, Oct. 16). In this era of sad performances by so many American chief executives, there are several key things your reviewer missed about Sandy's career.

First, he could cut costs, unlike most Wall Street CEOs. Second, he made people perform better than they ever thought they could. Key employees would do anything to get the approval of "Big Daddy," and his aura raised everyone's level of play. Lastly, unlike so many in the modern CEO ranks, Weill made money for everyone who bet with him. One old employee said to me several years ago: "He made more [people] into millionaires than any CEO in American history." Not a bad legacy.

–John D. Spooner
Boston

THESE MARKET LESSONS FOR EDUCATORS GET AN 'F'

MARIE GRYPHON'S ideas in "Better teachers: A lesson plan" (Ideas: Outside Shot, Oct. 16) won't work. Here's why:

Corporations won't pay the higher taxes needed to feed the budget for dynamic math and science teachers. There is a serious shortage of math and science talent in America, which creates market demand. But businesses can simply pay more for the math and science talent available. Public education can never compete dollar for dollar while such a shortage exists.

Gryphon's market approach might sound good, but it isn't realistic. I guess that's why some of us actually work in schools while others dream fanciful dreams in ivory towers.

–Kevin Brisbois
Tualatin, Ore.

CORRECTIONS & CLARIFICATIONS

In a table in the story "Cleaned up but falling behind" (News & Insights, Oct. 16), Legg Mason was spelled incorrectly due to a production error.

In "Boeing's border control" (News & Insights, Oct. 23), the length of the fence was incorrectly stated due to an editing error. It should have said 6,000 miles.

In "The high price of admission" (Cover Story, Oct. 23), the 10 business schools in the table "Slowest Return" were mistakenly listed in reverse order.

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Douglas Coupland's life.

Cultural commentator. Author of *Generation X, Microserfs, JPod.* Two-fingered typist. Writes 2 hours a day and fills the rest with design work, sculpture, TV and film projects. "I've basically turned my life into art school." Avid beachcomber in search of artifacts of man and nature.

1. All audio and video files must be transferred to the smartphone before playing. Files can be transferred via USB cable, smartphone browser application or Bluetooth. For a complete list of supported media file formats visit www.blackberrypearl.com.

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Douglas Coupland's life on a BlackBerry Pearl.

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Tech&You

BY STEPHEN H. WILDSTROM

Media Storage's Growing Pain

More people are starting to download movies and TV shows as well as music. These files are often enormous—two gigabytes alone for a two-hou movie. This, plus all the photos you took on your 10-megapixel camera, creates an urgent need for storage. It makes sense to put this content on a big hard drive on your network, where all your computers can share it.

Alas, this turns out to be much harder than it should be. Stand-alone networked storage has been around in products such as Maxtor Shared Storage drives, but they required a fair amount of networking knowledge. The new Hewlett-Packard Media Vault is a big improvement. It's a box about a foot tall that looks like a shrunken HP Pavilion minitower, with up to 1,200 gigabytes of disk space.

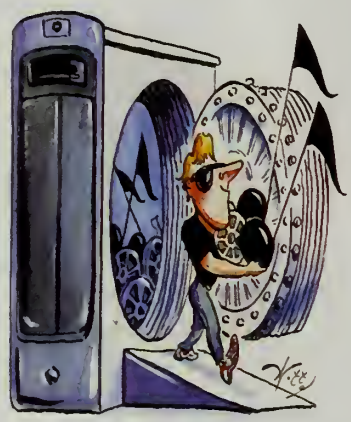
Maxtor is a respected name in storage, but the HP brand is likely to make consumers a lot more comfortable. In addition to a low base price of $379 for 300 gigabytes, it comes with software that you load on each PC. This makes it easy to store and retrieve movies and music, avoiding the difficulties of Windows computer-to-computer file sharing. Still, there are big problems to solve, especially for video, before this sort of media sharing can really hit the consumer mainstream.

One of the hurdles has to do with the capacity of wireless networks. Today's Wi-Fi can't reliably stream high-quality video without lurches and hiccups. This should be fixed by a faster edition of Wi-Fi that's now coming to market, though of course you'll have to purchase a new base station and PC adapter. You may also get better results using your home electrical wiring for networking. The latest technology, called HomePlug AV, should be fast enough for quality video. I'll be reporting on fast Wi-Fi and HomePlug AV in a future column.

THE COPY PROTECTION SCHEMES that lock up entertainment content, especially movies and TV shows, pose a far more daunting challenge. To make Media Vault easy to use, HP struck a deal with a movie download service called CinemaNow. It works quite well. But other online distributors of movies and TV shows, including MovieLink, Amazon.com's Unbox, and Apple Computer's iTunes Store, use digital rights management software that makes it difficult or impossible to use Media Vault or any other shared storage. Both MovieLink and Unbox, for example, refused to recognize my networked drive as a valid storage location.

The iTunes Store posed a different challenge. At one point, I tapped into the Media Vault to play video that I had purchased and stored, following the rules. But when I tried to watch a TV s on a second PC, iTunes told me I had alrea authorized the maximum of five devices. T watch, I had to deauthorize the first comp

By contrast, sharing of unprotected mu such as songs copied from my own CDs, and photos worked just fine. I was able to stream music from the Media Vault to PCs Macs, and networked players, including a Slim Devices Squeezebox and a Sonos Dig Music System. Players that use the Univer Plug and Play standard, such as the Roku SoundBridge and the Xbox 360, can play music from the Media Vault without running any software such as iTunes, on a network computer.



Copy protection schemes pose a daunting challenge

For years I've watched den in which video zipped aroun simulated homes on flawless wireless networks. My experi with the Media Vault shows h great the distance is between reality and that happy ideal.

Shared storage is a vital pi of making digital entertainm work. Once I have bought a movie, a TV show, or a song, I should be able to play it on any device I choose on my network. The technology exist to allow content from any source to be shared throughou home while still guarding against piracy. But with conte owners and distributors all insisting on their own flawed proprietary protection schemes, the position of consume well nigh hopeless. ■

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MediaCentric
BY JON FINE

NBC's Script Needs a Rewrite

It's not a great time to be Jeff Zucker. The CEO of NBC Universal Television Group is under pressure from General Electric boss Jeffrey R. Immelt to revive the flailing network in the face of intense competition from the online world. If Zucker doesn't do it quickly, he could lose his chance to succeed Bob Wright as chief of all of NBC Universal. Yet Zucker has chosen a remarkably tentative plan for turning the network around—whacking jobs and promising to rethink its prime-time lineup. Granted, it's not tentative to those affected by the 700 jobs that are being cut (out of 14,000) or the $750 million in expense reductions. (Some of these savings will be plowed into boosting the company's online presence.) But none of this will completed until the end of 2008.

It's hard to see how cutting a few hundred jobs and goosing digital revenues will stabilize a wheezing business model. The same goes for the new focus on reality or game shows instead of scripted series for the first hour of prime time. (Early headlines on this point caused a ruckus, which is why the network is walking it back: NBC Entertainment President Kevin Reilly now calls such plans "a target, not an absolute.") In short, broadcast TV's production costs are too high, competition is stiffening, and consumers are looking elsewhere.

THIS FALL SEASON, the networks won kudos for spending big to pump up the quality. However, hefty bets on the likes of NBC's *Studio 60 on the Sunset Strip* and CBS' *Smith* did not result in a ratings bonanza. Why? When it comes to hits, as screenwriter William Goldman once put it, no one knows anything. Here's what we do know: Scripted network TV keeps getting pricier. NBC's most promising new entry, *Heroes*, has no stars, yet it costs $2.7 million an episode. "We've gotten the public comfortable with very high quality of execution," says Reilly. "It's hard to get the genie back in the bottle." Union rules are partly to blame, along with the competition for top talent that keeps jacking up costs. (Imagine what *The Sopranos* creator David Chase will get for his next project.)

It's TV's slavish devotion to satisfying viewers' perceived demand for high production values for scripted series that really ties execs' hands. Yet think of the wildly different looks of *The Blair Witch Project, Crash,* and *Titanic*, which show that there are many routes to massive movie profits. There is no such assumed tolerance for varying approaches to scripted network series, and there is nothing lo-fi on nonreality network TV. Even the plainest sitcoms are shot well, lit sharply, and loaded with glossy surfaces. This puzzles some pros. "You should, theoretically, be able to do a comedy for much less," says one cable programming exec, if you "cast unknowns, control the process yourself, and shoot it" cheaply. Underline "theoretically," because the best minds at the Big Three haven't come up with a way to do a scripted series as cheaply as *Deal or No Deal*, which costs just over million an episode.

Why not spend less on dramas and comedies or hook up with Yahoo?

NBC Universal can lay claim to an escape hatch—the Web and other New Media offshoots. The company's digital-related revenues will be around $400 million this year, and the goal is for them to top $1 billion by 2009. (New initiatives include a revamped cnbc.com, due in December, and a rollout of more MySpace-like features on iVillage.com early next year.) Total NBC Universal revenues last year: $16.5 billion. Assuming flattish growth—which is generous for big media players these days—this means that even after three years, digital revenue will be well below 10% of the company's total. That means NBC's digital initiatives won't open an escape hatch you can wriggle a network's old infrastructure through. Of course, there are other moves that could amp up digital initiatives in a big way. Attention Messrs. Zucker and Immelt: There's the company called Yahoo! It gets lots of Web traffic, but it's lost traction. Maybe your bankers should give them a call. ■

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JAMES C. COOPER

A Do-Nothing Fed Is Looking Less Likely

gns point to inflation heating up. That could bring rate hikes back

U.S. ECONOMY The notion that the Federal Reserve will be cutting terest rates next year is rapidly losing support on Wall Street. The ea was pushed hard in the third quarter by several big-time players the bond market who believed the housing slump would hammer e economy, and it was responsible for a huge bond rally that pushed asury yields sharply lower across the maturity ctrum. Now most analysts have seen the light. Yields, le still low, are heading up again, and stock investors n happy in the belief that maybe the Fed will be on l for quite a while.

'ed policymakers did little to dispel that belief at their . 24-25 meeting. In fact, judging by the Fed's decision eep its target rate at 5.25% for the third consecutive eting, the Fed seems to believe patience is a virtue. ough inflation outside of energy and food is running ve the central bank's 1%-to-2% comfort zone (chart), economy's slower pace in the middle two quarters 006 gives policymakers reason to wait for price ssures to ease in the coming year.

However, investors beware. Several factors are coming ether that could cause the Fed's patience to wear 1. By the Fed's own accounting, there is not as much k in the economy as its policymakers saw only a few nths ago. That means the economy has less room row without putting added pressure on inflation. ther complicating that issue, the economy appears e regaining some momentum in the current quarter, ecially from faster consumer spending. The new risk: ation could remain stubborn enough to provoke the into raising rates sometime next year.

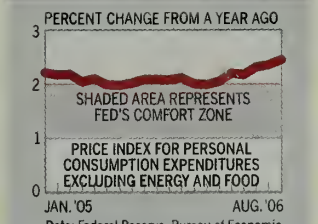
'or now, the markets are taking the Fed at its word nd its forecast. The policymakers' statement after the . 25 decision highlighted the Fed's belief that "the nomy seems likely to expand at a moderate pace" and t "inflation pressures seem likely to moderate over e." But at the same time, the Fed made clear that it tinues to believe the risk of higher inflation is greater n the risk of a weak economy. That means any future icy action is biased toward raising rates, not holding m steady, and certainly not toward lowering them.

E NEW FACTOR in Fed policy is the revival of an debate, last joined in the late 1990s: What is the nomy's noninflationary "speed limit," or the growth e over the long run that allows the economy to make l, but not excessive, use of its resources? The question mportant because if, at any given time, the economy is not fully utilizing all of its available workers and production facilities, then inflation pressure can ease. However, as that gap between actual and full utilization closes, it becomes much harder for inflation to slow.

The new focus on the issue came to light in the minutes of the previous Fed meeting on Sept. 20. They said the Fed's research staff had lowered its estimate of the speed limit for the second time in as many meetings. Those downgrades reflected the government's recent downward revision of real gross domestic product from 2003 to 2005, and the upward refiguring of job growth from March, 2005, to March, 2006. That combination has cut into productivity growth, the most important factor in the economy's noninflationary growth limit.

As a result, the researchers concluded, the Fed's forecast for growth in the coming quarters "was consistent with an opening of only a small gap in resource utilization." In plain English: Inflation might be very slow to ease, and if the economy's growth rate exceeds the Fed's forecast, inflation might even rise further. Many private economists believe, even if the Fed's forecast for "moderate" growth holds, more than "only a small gap" between actual and full resource use will have to open if inflation is to drift lower.

NOT HEADED IN THE FED'S DIRECTION



Data: Federal Reserve, Bureau of Economic Analysis, Global Insight Inc.

ALL THIS MAKES the economy's future growth rate paramount in figuring out what to expect from Fed policy over the next several months. Analysts who still believe the Fed will start cutting rates sometime next year expect a soft economy. Those who look for further hikes think the economy is percolating nicely.

So what's the Fed's view? The policymakers' most recent forecast, released back in July, implied growth in the second half of 2006 would slow, from about 4% in the

first half, to about 2.5%, with the pace picking up a bit to the 3%-to-3.25% range during 2007. Although growth did slow significantly in the third quarter, the new development is the economy's apparent reacceleration in the fourth quarter, to a pace most likely faster than what the Fed has been expecting.

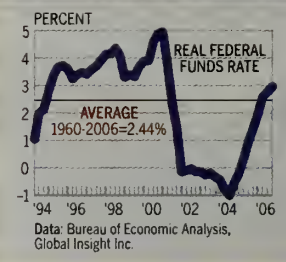
That speedup is partly a result of plunging energy prices, which are having an uplifting effect on consumer purchasing power and corporate spending plans. Earlier this year, rising energy prices had been one of the Fed's inflation concerns, to the extent that companies might be expected to pass along higher fuel costs in the prices of their products. However, costlier energy was also a headwind that helped to slow economic growth. Now, cheaper energy has turned into a tailwind.

Faster economic growth could make the Fed's expectation of lower inflation that much tougher to achieve, especially given the economy's lower speed limit. Right now, policymakers expect their preferred measure of core inflation, which excludes energy and food, to end 2006 in the 2.25%-to-2.5% range, before slipping to the 2%-to-2.25% band by yearend 2007. However, by August, yearly core inflation had already picked up to 2.5%. That's the top end of the Fed's forecast range, and a half-point above its stated comfort zone.

PERHAPS THE MOST IMPORTANT question policymakers will grapple with in coming months is this: Is a 5.25% target rate restrictive enough to keep the economy from outgrowing its available labor and production facilities? That is, will current policy keep the economy from overheating? After all, the unemployme rate is already at a five-year low of 4.6%, and the percentage of industrial output capacity in use has stay above its long-run average of 81% almost all year.

In fact, despite the Fed's 17 quarter-point rate increa since June, 2004, nearly all signals point to financial conditions that are stil very accommodating t growth. Unlike during past episodes of Fed rate-hiking, banks wer still easing their lendir standards this past summer, and the narro spread between yields on corporate bonds an Treasury notes implies the credit markets see little risk in lending.

IS FED POLICY TIGHT ENOUGH?



Data: Bureau of Economic Analysis, Global Insight Inc.

In addition, the Fed real policy rate, the rate adjusted for inflation, currentl stands at only about 2.8%, just slightly above the long run average of 2.4%. During the tightening cycles of 1 and 2000, the real policy rate peaked at 3.8% and 5%, respectively (chart). By that metric, policy remains eas compared with past episodes.

For now, Wall Street seems to be buying the Goldilo scenario—an economy that's not too hot and not too c However, chances are increasing that this porridge co start to heat up, a situation that would begin to try the Fed's patience. ■

BUSINESS CONSTRUCTION

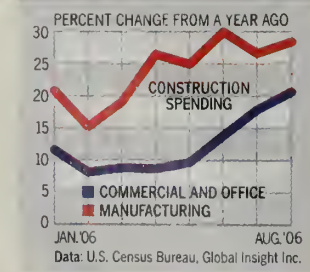
Strong Medicine for Weak Housing

THE RECENT slowdown in economic growth hasn't put a dent in business construction. Demand for office and factory space continues to outstrip supply. As that demand is met, nonresidential building will keep offsetting much of housing's decline.

Nonresidential construction is expected to show another solid increase in September. Lehman Brothers economist Michelle Meyer expects a monthly gain of 0.5%. That would keep the yearly pace of growth around 20% for a fourth straight month.

The strong growth is partly a response to a decline in available space. In the third quarter, the net amount of occupied space rose more than 20 million square feet, while just 7.3 million square feet was completed, according to CB Richard Ellis, a commercial real estate services company. The vacancy rate fell to 13.7% in the third quarter, from 14.2% in the prior period, and rents ticked higher, indicating some degree of pricing power.

BUSINESSES KEEP ON BUILDING



Data: U.S. Census Bureau, Global Insight Inc.

The story is similar in the industrial sector. The vacancy rate for industrial space was 7.9%, the lowest since 2001. Factory output continues to outpace capacity growth, even as production has slowed recently. In September, production grew 6.3% from a year ago, while output capacity expanded by 2.7%.

Distribution centers and ports a where demand for more facilities i especially strong, according to Wa Caswell, director of research at CB Richard Ellis. The rise in both imp and exports is raising demand in t industrial building category.

Nonresidential construction gains have offset a large part of th plunge in residential activity, ever though the commercial sector is a little more than half the size of th housing market, in dollars. This y residential outlays have fallen $4 billion, compared with a $37 billi jump in the nonresidential area. The trend should persist. Data sh the housing slump may be close t hitting bottom, and its impact on consumers still appears minimal, which is likely to keep businesses an expansion mode. ■

–By James Mehring in New

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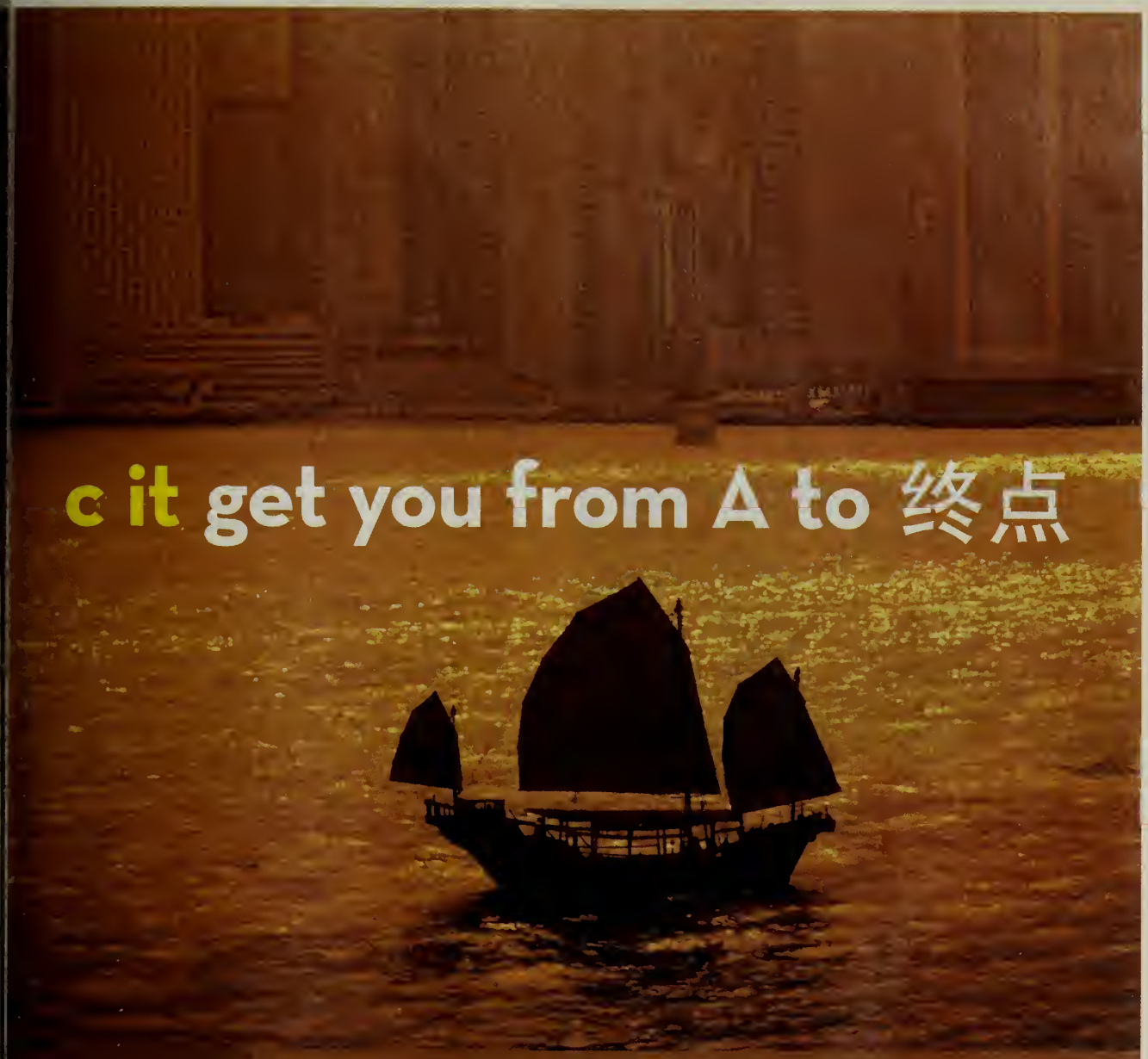

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News you need to know

EDITED BY HARRY MAURER

Dismal Detroit U.S. carmakers keep lurching from one disaster to another. Just as **GM** showed a small third-quarter operating profit of $529 million, about $450 million of which came from one-time tax gains, **Ford** and **Chrysler** reported hulking losses. Ford bled $5.8 billion, including some costs for its downsizing plan. Chrysler dropped $1.5 billion as its sales sank 26% (a California lot, photo).

Don't look for the curse to lift soon, either. Chrysler has production cuts coming that should clobber profits again. Analysts expect it to lose as much as $1 billion next year, probably bringing more job losses, or even a spin-off. Speaking to analysts on Oct. 25, **DaimlerChrysler CFO Bodo Uebber** didn't say Daimler is looking to carve out Chrysler, but he didn't deny that it's an option. Meanwhile, Ford faces such a cash crunch that it must secure financing with its factories to get better rates as it pays billions to buy out workers. All in all, a spooky Halloween in Motor City.

ONLINE *See "Crisis at Chrysler," "Ford: Q4 will be even worse," and "Mulally's message," www.businessweek.com/go/tbw*

Skilling: Hard Time Ouch. On Oct. 23, former **Enron CEO Jeffrey Skilling** was sentenced to 292 months in the slammer. That's eight months shy of the 25 years handed to **ex-WorldCom** chief **Bernard Ebbers,** a record in a white-collar case. Skilling maintains his innocence and plans to appeal, but **Judge Simeon Lake III** denied his request to stay out of the pen until the appeal is decided. And in New York, **David Kreinberg,** former CFO of **Comverse Technology,** pleaded guilty to securities fraud for his role in backdating stock options. He's expected to provide evidence against former **CEO Jacob "Kobi" Alexander,** who's fighting extradition from Namibi

ONLINE *See "Q&A: Skilling's lawyer on t appeal," www.businessweek.com/go/tb*

CEO Watch Something's cooking at a couple of top foo makers, **Kellogg** and **Wrigley,** which both named new CE on Oct. 23. There wasn't much snap, crackle, or pop ov the news that heir apparent **David Mackay,** president a chief operating officer, nabbed the top spot at the cere maker, effective Dec. 31. But the appointment of **Willia Perez,** ousted **Nike** chief, at Wrigley marks the first time t gum purveyor has gone outside the family in the comp ny's 115-year history. Also on the corner-office fro British mining behemoth **Anglo American** on Oct. 24 pick longtime **Alcan** executive **Cynthia Carroll** to take over as C next March. She's the first woman to hold such a high p in the macho world of natural resources.

ONLINE *See "Why Wrigley and Perez need each othe www.businessweek.com/go/t*

Old Tech vs. New **IBM** claims diplomacy didn't work, s was forced to go to war. On Oct. 23, Big Blue sued **Amazon.c** over what it claims are violations of five basic e-comme patents. IBM has the world's largest patent portfolio, colle $1 billion a year in royalties, and rarely sues, but says that ter four years of talks it has run out of patience with Amaz It pegs a possible judgment or settlement in the hundreds millions. Amazon, which reported lower earnings but dar revenues on Oct. 24, declined comment.

ONLINE *See "IBM takes on Amazon" and "Amazon turn a smart third quarter," www.businessweek.com/go/t*

Private Equity Hunters Where there's trouble, the p vate equity pack can't be far behind. At least six groups showing interest in **Tribune Co.,** owner of the *Los Ang Times, Chicago Tribune,* Long Island-based *Newsday,* the perennial hard-luck Chicago Cubs, according to *Tribune.* The company, whose papers are losing read fast, is expected to weigh all offers before even decid whether to sell itself—whole or in parts. Meanwhile, **plewood** is kicking the tires at bankrupt auto parts ma **Delphi** and might pony up a bid to rival one led by **Appalo Management** and **Cerberus Capital Management.**

Bernanke at Rest As everyone figured, the Fed sat t on Oct. 25, leaving its benchmark rate at 5.25%.

See "A do-nothing Fed is looking less likely," pag

Chairman Icahn Famed raider **Carl Icahn** refuses to up on **ImClone.** After packing the board and forcing out CEO, Icahn, ImClone's second-largest shareholder, named chairman on Oct. 24 and says he's determine figure out what's ailing the biotech. It's not the first t Icahn has paid a bedside visit to ImClone. A long friend and tennis partner of jailed founder **Samuel Wa** Icahn first invested in the company in the early 19 when, as a startup, it was in danger of passing away.

ırdoch vs. Malone Don't let the door hit you on the y out, John. That's the message from **Rupert Murdoch** to ın **Malone** after **News Corp.** shareholders on Oct. 20 ap- ıved a controversial poison pill defense that will keep lone at bay after his **Liberty Media** had amassed a 19% ınk of the media giant. Murdoch's family voted its 31% ke for the plan, which passed 57% to 43% despite votes large holders who had sued earlier to upend the plan. ll, Murdoch and Malone may yet kiss and make up. thin weeks, Malone is expected to swap his piece of ws Corp. for its 38% of satellite operator **DirecTV.**

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ntonville Slowdown Wal-Mart's hell-for-leather ex- ısion has come at a price: a slump in sales growth at its 00 stores, and a stock down nearly 20% from its 2001 ık. So on Oct. 23 execs said Wal-Mart would trim back w-store openings in the U.S. next year and hinted that savings could go toward stock buybacks. It worked: ares hopped nearly 4% the next day. **CEO Lee Scott Jr.** also mitted to analysts that the chain had "moved too far too t" with trendier clothing and promised to stock more of "fashion basics" that are the chain's stock in trade.

ı-Ga over Google When Google **CEO Eric Schmidt** told alysts on Oct. 19 that the search king's third-quarter re- ts were "very, very good," he sure wasn't kidding. ogle's net nearly doubled, to $733 million, on a 70% rise sales, to $2.7 billion. The stock shot up and kept going to all-time high of 480.78 on Oct. 23. Such strong num- rs contrasted pleasantly with those of rival **Yahoo!,** which lier had reported pallid profits.

ONLINE *See "How Google's garden grows," www.businessweek.com/go/tbw*

White Knight of the Week

ong considered a superhero, **Warren Buffett** swooped ı to save the day at **Lloyd's.** On Oct. 20, Buffett's **Berk- hire Hathaway** agreed to take on the liabilities of re- nsurer **Equitas,** created by Lloyd's in 1996 to handle its sbestos and other massive claims. The deal, in which Berkshire will provide up to $7 illion in additional reinsurance rotection to Equitas, puts to rest ears that it would run out of noney. Berkshire also gains con- rol of Equitas' $8.7 billion in re- erves, which the Oracle of Omaha an use to invest, pursuing profits n excess of the claims. It looks like isky business: Asbestos lawsuits ıave been a nightmare for U.S. ompanies and their insurers. But Berkshire, with what Buffett calls its "Gibraltar-like [financial] strength," spe- ializes in the riskiest risks. Berkshire bought the trou- led North American business of Swiss reinsurer **Converi- ım** a few days earlier. Investors don't seem fazed: Shares of Berkshire soared past $102,000, a record even for this notoriously pricey stock.

WARREN BUFFETT

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"We got caught in a circle, and couldn't get out."

—*Bernice Thompson*

CONSUMER DEBT

CAP ONE'S CREDIT TRAP

By offering multiple cards, the lender helps land some subprime borrowers in a deep hole and boosts its earnings with fee income. BY ROBERT BERNER

WHEN BRAD KEHN received his first credit card from Capital One Financial Corp. in 2004, it took him only three months to exceed its $300 credit limit and get socked with a $35 over-limit fee. But what surprised the Plankinton (S.D.) resident more was that Cap One then offered him another card even though he was over the limit—and another and another. By early 2006, he and his wife had six Cap One Visa and MasterCards. They were in over their heads.

The couple was late and over the limit on all six cards, despite occasionally borrowing from one to pay the other. Every month they chalked up $70 in late and over-limit fees on each card, for a total of $420, in addition to paying penalty interest rates. The couple fell further behind as their Cap One balances soared. Even so, they still received mail offers for more Cap One cards until they sought relief at a credit counseling agency this May. "I didn't open them," says Kehn, 33, who manages a truck stop and runs a carpet-cleaning business on the side. "I owe these people that much damn money and they are willing to give me another credit card? This is nuts."

Credit card experts and counselors who help overextended debtors say there's nothing crazy about it. Cap One, they contend, is simply aiming to maximize fee income from debtors who may be less sophisticated and who may not have many options because of their credit history. By offering several cards with low limits, instead of one with a larger limit, the odds are increased that cardholders will exceed their limits, garnering over-limit fees. Juggling several cards also increases the chance consumers may be late on a payment, incurring an additional fee. And if cardholders fall behind, they pile up over-limit and late fees on several cards instead of just one. "How many more ways can I fool you?" says Elizabeth Warren, a Harvard Law School professor who has written extensively on the card industry. "That is all this is about."

Consumers may not be the only ones who are unaware of Cap One's ways. Its practice of issuing multiple cards to some borrowers with low credit ratings doesn't appear well-known in the investment community. And just how much Cap One relies on fee income, vs. interest, is a mystery, since, like most lenders, it doesn't disclose that. All credit card companies have become more reliant on fee income in recent years, but in a report issued in 2002, William Ryan, an investment ana-

ANN STATES

lyst at Portales Partners, warned that Cap One's earnings could be "devastated" if regulators cracked down on multiple cards or fees.

That hasn't happened. For now, Cap One's approach looks pretty savvy, however onerous it may be for some customers. Ronald Mann, a card-industry expert, says that by generating so much revenue from late and over-limit fees, as well as interest, Cap One likely more than offsets for the risk of card holders filing for bankruptcy. "The premise is to make money even if [Cap One] never gets fully repaid," says Mann, a law professor at the University of Texas in Austin. (Mann has been retained by a party suing Cap One in a business dispute.)

In a written response to questions, Cap One acknowledges that it offers multiple cards. "Our goal is to offer products that meet our customers' needs and appropriately reflect their ability to pay," it says. The company also stated: "Within our current U.S. portfolio, the vast majority of Capital One customers have only one Capital One credit card with a very small percentage choosing to have three or more cards." Spokeswoman Tatiana Stead declined to offer precise numbers or to say whether households with three or more cards were concentrated among "subprime" borrowers, who have low credit ratings.

UNDER THE RADAR

THE NATION'S fifth-largest credit card issuer, with $49 billion in U.S. credit card receivables as of the end of June, McLean (Va.)-based Cap One is a major lender to the subprime market. According to Cap One's regulatory filings, 30% of its credit card loans are subprime. Representatives of 32 credit counseling agencies contacted by *BusinessWeek* say that Cap One has long stood out for the number of cards it's willing to give to subprime borrowers. "In the higher-risk market, no lender is more aggressive in offering multiple cards," says Kathryn Crumpton, manager of Consumer Credit Counseling Service of Greater Milwaukee. Other big card-industry players that do subprime lending include Bank of America, Chase, and Citigroup. Representatives for Chase and Citigroup say they do not offer multiple cards to subprime customers. (BofA did not respond to inquiries.)

Last year, West Virginia Attorney General Darrell V. McGraw Jr. filed an action in state court seeking documents from Cap One related to its issuance of multiple cards, as well as other credit practices. Other than that, however, Cap One's practices do not appear to have drawn regulatory scrutiny. A spokesman for the Federal Reserve, Cap One's primary federal overseer, declined to comment about Cap One, but said that in general the regulator doesn't object to multiple cards. Still, Fed guidelines warn multiple-card lenders to analyze the credit risk tied to all the cards before offering additional ones.

If consumers were using one Cap One card to make payments on another, it could artificially hold down the company's delinquency and charge-off rates, metrics investors closely watch because they affect earnings, says Allen Puwalski, senior financial analyst at the Center for Financial Research & Analysis in Rockville, Md. In filings with the U.S. Securities and Exchange Commission, Cap One says its delinquency and charge-off rates as of Sept. 30 were 3.6% and 2.5%, respectively, about middle of the pack for major card lende

In an e-mail, C One's Stead says: "It not our practice—n our intention—to off an additional card customers who are cu rently delinquent over limit on a Capi One card." But Dan Carvajal believes tha just what Cap One tri to get him to do. Car jal, 38, who is confin to a wheelchair w cerebral palsy and li with his mother in M mi, says he exceed his $1,500 Cap C credit limit last Chri mas by several hundr dollars and was late payments in Janu and February. March, he says, a C One representative fered him a sec card, which he refus Using the new card catch up with his fi he suspects, "is w they wanted me do t

Some overexten Cap One customers mit using one card pay another. In n 2005, Kehn, the So Dakota truck-stop m ager, already over limit on three Cap cards with $300 $500 limits, receive offer from Cap One another card with a $500 limit. He tr ferred part of the balances from the three cards to get them under the cr limit. When his wife got a second car early 2006 with a $1,500 cap, the co took expensive cash advances on it t to help make payments on the five o Cap One cards. "I robbed Peter to Paul," Kehn says.

Christine Garcia, 41, of Orange, C said she and her husband did the s when stretched with five Cap One c between them. So did Bernice Thomp 46, of Fort Smith, Ark., who, along her husband, had seven Cap One c "We got caught in a circle, and cou get out," says Thompson.

These examples bring into que Cap One's public stance on its subp lending. Analysts, including Carl ratings director on card securitizatio

Juggling Act:

How Clyde and Bernice Thompson of Fort Smith, Ark., got in trouble

» From late 1999 to early 2003, Clyde, 77, and Bernice, 46, were granted seven Capital One Visa cards and MasterCards with credit limits ranging from $200 to $700.

» In April, 2003, Clyde, a Wal-Mart greeter, and his wife, who was on medical disability at the time, missed their monthly payment on all the cards.

» They were billed $29 a card in late fees, which pushed six cards over the limit. That generated an additional $29 over-limit fee and higher interest rates on those cards.

» By late 2003, the Thompsons couldn't keep up, despite taking cash advances on the seventh card to try and pay the first six. They were paying over $400 a month in late and over-limit fees alone.

» The couple kept receiving mail offers for more Cap One cards until February, 2004. "I tore them up," says Bernice.

Data: Interview with Bernice Thompson

ndard & Poor's, say Cap One tells in-tors that it carefully controls risk by ing such borrowers only small lines of dit. Indeed, the largest percentage of) One's 28 million credit-card ac-nts, 43%, have balances of $1,500 or ;, according to its SEC filings. But if ny borrowers had larger aggregate ances because they have multiple ac-nts, that percentage would be lower, l Cap One's "underwriting wouldn't ear as conservative as it looks," says Financial Research Center's Puwalski.

Like other big card companies, Cap One securitizes most of its card receivables as bonds, which are rated by credit agencies such as Standard & Poor's (S&P is a unit of The McGraw-Hill Companies, publisher of *BusinessWeek*). Cap One's ratings are strong, allowing it to command a higher price for the bonds. But Neff of S&P says he is surprised Cap One would offer riskier borrowers multiple, low-limit accounts given what it has told the market. "If it was a very prevalent practice, that would lower [Cap One's credit] quality in our eyes," Neff says. A sampling of credit counseling agencies across the country indicates that about a third of the troubled debtors they see with Cap One cards have two or more Cap One accounts.

Ron Nesbitt, 37, a Macon (Ga.) truck driver, and his wife sought credit counseling last year. By the second half of 2004, Nesbitt says, the couple had become consistently late and over limit on six Cap One cards, generating $348 in fees alone each month. "It was out of control," he says. ■

SIDERS

IOT AS RANDOM AS IT LOOKS?

ome executives seem to be making g gains in automatic trading plans

JANE SASSEEN

JOHN B. BLYSTONE APpeared bullish on the prospects of SPX Corp. back in late 2003 and early 2004. In his role as chief executive of the Charlotte (N.C.) industrial goods maker, he pped investors to expect strong earns and a sharp rise in free cash flow. And emphasizing the sustainability of those ns, he helped send the stock rocketing m 48 to nearly 62, before it settled back 53 by late February.

Blystone also told investors that for ersonal financial and estate planning poses" he had set up a prearranged ding plan in January to diversify his dings. By Feb. 25, according to a ureholder lawsuit filed later that year, stone had sold 800,000 shares valued $45.3 million.

Then came the bombshell: On Feb. SPX announced its results. Furious estors fled the stock when they real-d that one-time gains accounted for ch of the jump in earnings and cash w. SPX shares dropped 21%, to 42, in a 7. Before long shareholders filed suit eging that Blystone knew things ren't as rosy as projected when he set his automatic trading plan.

In theory, that isn't supposed to happen. Blystone did his trading through what's known as a 10b5-1 plan. The Securities & Exchange Commission created such prearranged trading plans in 2000 to clarify the rules under which executives can legally sell shares they've accumulated. As long as they initiate the plan at a time when they don't know of any significant nonpublic information, lay out in advance the dates or prices at which sales will be made, and don't control the trades, they are legally protected from insider trading charges.

But questions are growing as to whether executives such as Blystone are finding ways around those restrictions to boost their returns. According to recent research by Alan D. Jagolinzer, an assistant professor at the Stanford University Graduate School of Business, some executives appear to be making better-than-expected gains while trading within 10b5-1 plans. Not only do plan participants tend to beat the market, they also appear to do significantly better, on average, than other insiders who do not set up automatic trading plans. One reason is that they sell shares in advance of negative news twice as frequently as they sell ahead of good news.

All of which leads to an obvious question: Are executives using inside dope when they set up such plans? "What this suggests is that when executives know negative news is coming, they contract out a plan and direct it to sell," says H. Nejat Seyhun, a finance professor at the University of Michigan's Ross School of Business. "They are making an end run around the insider trading laws."

Until now, little study has been done on trading within 10b5-1 plans, in part because comprehensive data are hard to

come by. Executives simply set up a trading schedule with their lawyer and their broker; SEC rules don't even require them to publicly disclose that they've created one. But the plans have been more widely adopted and disclosed in the last couple of years, thanks to the legal protections they offer. For his study, which is under peer review, Jagolinzer compiled data from available disclosures on nearly 100,000 trades—the vast majority of them sales—made by 2,995 insiders at 1,016 companies between 2003 and 2005. In a preliminary analysis, he found that trades inside 10b5-1 plans beat the market by 5.6% over six months.

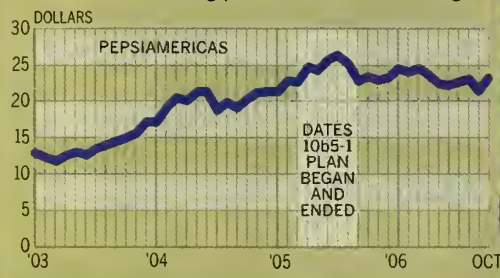
That appears to confirm results Jagolinzer came up with last year based on a sample of 191 companies. Back then, he found that participants in 10b5-1 plans outperformed the market by 4.8%, while insiders at the same companies who did not enter prearranged plans lagged the market by 2.9%.

Moreover, he found, sales by plan participants take place ahead of price declines more often than not. Executives initiated 10.4% of their sales ahead of negative earnings news, on average, while only 5.2% came in advance of positive earnings news. "If executives were initiating plans without any inside information, you would expect those sales to even out," Jagolinzer says. "It's like Vegas: Any individual might win, but average everyone out, and you should see winners and losers split 50-50."

So what explains the pattern showing up in the Stanford study? Jagolinzer emphasizes that it's difficult to tell from the numbers alone, and none of it necessarily implies anything illegal. But the data suggest several possible explanations. One is that insiders may sense that a company's fortunes are turning well ahead of when weaker earnings are announced. A key product may not be panning out, or early signs of a sales slowdown may be starting to show up. "People hear things aren't going well; they pick up on a bad vibe," says Jesse M. Fried, co-director of the Center for Law, Business & the Economy at the University of California at Berkeley School of Law. "There's a lot of valuable information floating around a company to trade on that doesn't rise to the standard of being 'material' legally."

GOOD TIMING

President Kenneth Keiser began, then ended, an automatic trading plan as the stock hit highs



Data: Bloomberg Financial Markets, Company filings

Others suggest executives, watching their stock run up, may worry that it is getting overvalued, or they may simply want to take some money off the table. Mark LoPresti, who tracks insider trades for Thomson Financial, says many execs, particularly in tech, seem to enact trading plans when stocks return to the levels not seen since the boom years. "The insiders know the previous high, and they may be fearful that the stock may back off again," he says. Whatever the reason, the result is a pattern that can lead to relatively favorable results: Stock plans are enacted as a stock runs up toward a peak, and often the trading slows or stops altogether when the stock declines.

SIMILAR PATTERNS

TAKE, FOR EXAMPLE, stock sales made by executives of Barr Pharmaceuticals Inc. last year. Several executives, including CFO William T. McKee and President Paul M. Bisaro, set up 10b5-1 plans in the summer and fall. After bouncing between 35 and 50 for the previous 18 months, Barr shares took off in September on strong earnings and new generics. As the stock headed up to $68.70 in February, 2006, the executives—along with others—sold heavily, according to company filings. When patent problems caused the shares to tumble to 45 in July, much of the selling stopped. Barr declined to comment.

Sales made by Kenneth E. Keiser, president of soda distributor PepsiAmericas Inc., show a similar pattern. From a low of 11.19 in early 2003, its shares rose to peak above 26 by mid-2005. In February, of that year, Keiser initiated a plan to sell 15,000 shares a month through December. But he ended it in Se tember, as the stock head back to around 22, where still trades.

Keiser says he set up t plan to diversify his holdin having never sold a share the previous five years. A he says he stopped the pl because the company w engaged in discussions th may have had an impact the stock. "I felt it wasn't a propriate, so I canceled t plan," he says.

The patterns suggested Jagolinzer's study also raise the possibil that executives, knowing the dates which their shares will be sold, may som times be able to delay the release of b news until after the sale. That essentially what shareholders in SPX alleged. Both t company and Blystone, who resigned u der pressure later in 2004, have said the legations are without merit, and ha sought to have the suit dismissed. Blyst could not be reached for comment.

There's one other factor that appears show insiders don't leave the timing their trades entirely to chance: plan ter nations. The data here are even m sparse, as many execs don't disclose wh they stop their pre-arranged plans. those who do show a discernible patte Executives have a tendency to stop th planned sales just before the stock ta off. Often they resume selling when pri are higher. While there is nothing illega that—after all, no one can be forced to c tinue selling shares—it belies the ar ment that executives wishing to diver simply put their trades on autopilot.

All of which suggests investors ou to pay more attention to trades d within 10b5-1 plans and the signals t send. Thomson's LoPresti says invest tend to ignore such trades, assuming t are out of the control of executives. that, he argues, is a mistake. "The that a trade is being done through a p doesn't negate its impact," he says. deed, Thomson is putting together own database of 10b5-1 plans to track trades more closely. The SEC, too, looked at the possibility that such tra can be manipulated. Jagolinzer may among the first to look closely at their pact, but he won't be the last. ■

–With Susan Zegel and John C

Executives who used prearranged trading plans to sell their company shares beat the market on average by 5.6% over six months

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BRINGING IN JOBS Tovey and Minthorn on the future site of Cayuse Technologies

NEW SOLUTIONS

THE OTHER INDIAN OUTSOURCER

Accenture and the Umatilla tribes' bold plan

BY JENA McGREGOR

IT'S THE ONLY BOARD PRESENTATION Accenture Managing Director Randall L. Willis has ever made in a trailer, wearing shorts and flip-flops, surrounded by a buffalo hide and photos of Native American chiefs. During a vacation last August, Willis, who is Native American, stopped by the Confederated Tribes of the Umatilla Indian Reservation to visit a family friend and throw out a business idea.

Accenture Ltd. needed low-cost places to fill the growing demand for outsourced work performed in the U.S. The Umatilla tribes, based in northeast Oregon, needed jobs and a way to diversify their gaming- and government-dependent economy. Would the tribes be interested in teaming up? Within minutes, Willis' friend ushered him into a tribal board meeting already in session, led by Chairman Antone Minthorn.

While the pitch to the board was impromptu, the idea wasn't. For the past year, Willis had been researching Native American tribes to find an appropriate partner. And on Oct. 6, Accenture announced a five-year agreement to manage Cayuse Technologies, an outsourcing business owned by the Umatilla tribes that will offer call center, document preparation, and software programming services. While Accenture will not share in Cayuse revenues, it will be paid a nominal management fee—and have a ready place to turn for low-cost onshore work. Demand, says Willis, is "tremendous" as government agencies require that more outsourced work be done in the U.S. and as private-sector companies seek cheap local options. "Whether it's cost concerns or security, a number of industries would like to keep it in the U.S," he says.

Call them the other Indian outsourcers. While a handful of tribes have set up outsourcing operations, Accenture's efforts mark the first time a major global tech-services firm has joined forces with tribes to create a low-cost domestic alternative. Native American tribes are similar to rural communities in that they have a very low cost of living and, therefore, much lower wages and real estate costs. Gartner Inc. Vice-President for Research Frances Karamouzis estimates that rural-based outsourcing work, and by extension, Native American outsourcers, offer at least a 10% to 30% savings on outside work performed in urban U.S. markets.

Working with the tribes may offer additional advantages. Their 17% unemployment rate, says Umatilla Economic Development Director and Cayuse board member Bill Tovey, is not high by Native American standards, but it still offers a population that's both in need of jobs and fairly stable, thanks to the ties the tribes have to the reservation. And because they don't pay corporate income taxes, the tribes can, potentially, charge lower rates. Eventually, they hope qualify for a Small Business Administ tion program that confers special sta when competing for government co tracts. Analysts say subcontracting to tribes will attract some clients looking fill requirements to work with minor owned businesses. "I'm surprised body else has looked at this yet," s Forrester Research Inc. government dustry analyst Alan E. Webber. "I thin has a high potential to work—if they develop the quality [workforce] th necessary."

THE STAT

10%-30%

Savings from "rural sourcing," vs. outsourcing to U.S. companies in urban areas

Data: Gartner Inc. estimates

COACHES AND TRAINERS

THAT'S THE SAME RISK Willis sees the venture, which will soon begin train workers and could eventually 250 people. Most employees will h had little or no relevant experience, Accenture's five-year contract puts i charge of ensuring that the work is u par. It will place coaches and Accen managers on site, as well as pro longer training periods (up to 1 months for some programming jo Whether or not the plan succeeds, Ac ture can walk away after its contract is

Of course, Willis, who is also co-c of the National Council of the Smith ian's National Museum of the Amer Indian, hopes the venture takes Eventually he would like to see a more Accenture-affiliated tribal sourcing locations. Plus, Willis more than just a professional respo bility to the venture's success. Not on he an Oglala Lakota, his wife is a m ber of one of the Umatilla tribes. ' last thing I wanted, from a personal spective, was to have this thing fail.'

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SAFETY NET Busy professionals like Kher and Walia are turning to the Web

THE INTERNET

HERE COME THE BRIDE SITES

U.S. Net heavies are wedding India's fast-growing matchmaking dot-coms

BY NANDINI LAKSHMAN

THERE'S YAHOO! Finance, Yahoo! Autos, and Yahoo! Jobs. So why not Yahoo! Weddings? In India, the Internet giant is playing online cupid to people looking for arranged marriages. In September, Yahoo! Inc. and Silicon Valley venture capital firm Canaan Partners jointly paid $8.5 million for what industry insiders say is roughly 10% of BharatMatrimony.com, a nine-year-old marriage Web site that also has 50 offices across India to serve those without Net access. "BharatMatrimony will help us get a larger share of the Internet market" in India, says Yahoo India Managing Director George Zacharias.

One satisfied customer is Pradeep Nair. The 32-year-old packaging material exporter from Mumbai tried finding a bride the traditional way: by hiring a matchmaker. "There was something or the other missing" with each of the 50 or so candidates, he says. Either her horoscope didn't match his own—a key consideration for conservative Hindus—or she fell short of his ideal: a tall, attractive working woman. Frustrated, Nair paid $27 to sign up with BharatMatrimony. Three months later, he wed Vrinda, 28, an accountant working for Indian carrier Je Airways. Nair plans to register his siste on the site next. "It's easy to access, and throws up good choices," he says.

EASY TO SAY "NO"

YAHOO ISN'T THE ONLY foreign playe getting hitched to an Indian marriag site. Microsoft Corp. a year ago hooked u with Shaadi.com, though it didn't inve any money in the site. "Shaadi helps a tract huge numbers of users," says MS India country manager Jaspreet Bindr Silicon Valley venture capital fund Klei er Perkins Caufield & Byers has plowe some $4.6 million into Info Edge, whic runs matrimonial site Jeevansathi.cor Google Inc. also is said to be prospectir for a partner, though the company d clines to comment.

There are plenty of potential mates f overseas Net companies. India has scor of sites dedicated to brokering marriage while Net dating services are less popul Some 7.5 million people use the marria sites, up from 4 million in 2004, the I ternet & Mobile Association of India es mates. Since registration is free, and use only pay when they want to contact a p tential partner, the sites are likely to ta in just $21 million or so this year. E there's plenty of room to grow. Indians out nearly $500 million a year for offli marriage services such as matchmakir the biggest category of print classifie "Today the emphasis is on compatibil and being a professional, something t Internet lets you test, as opposed to t traditional contacts," says Anupam M tal, Shaadi.com's founder.

The popularity of the sites reflects changing face of India. Traditionally, dian marriages have been brokered family, friends, or professional mat makers, a laborious process that invol matching candidates on the basis of r gion, caste, community, and horoscop Busy professionals such as Charoo K prefer the speed of the Net. A custom relations manager at India's commo exchange, Kher, 31, had no time for c ing so she registered on Shaadi.com. and her Punjabi family reviewed 100 o profiles—with details such as hobbies vorite foods, and salary—and settled Gurmeet Walia, a 35-year-old cate "The ease of finding many profiles on under one roof seemed practical," K says. The couple wed eight months a

Online matchmaking offers anot advantage: In India there's a stigma tached to turning down a marriage p posal. The Internet allows users to di gage easily if they don't, well, click.

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A Dragon in R&D

China's labs may soon rival its powerhouse factories—and multinationals are flocking in for tech innovation. **By Bruce Einhor**

WIRED A tech-happy generation is catching up to Western peers.

S A YOUNG MAN, ZHANG XIAOLIN DREAMED OF BECOMING A TOP search scientist. But to reach that goal, the native of China's An-ui Province felt he had to leave his homeland. Now, after two :cades in the U.S., he's back home again, and he couldn't be ıppier. Zhang will be heading up drugmaker AstraZeneca's ıanghai lab, where he says he expects "to do real innovative re-arch." Adds his boss, James Ward-Lilley, president of As-aZeneca China: "In 20 years, where do you see new ideas com-g from? A significant chunk will be from China."

It's the year of innovation in China. Led by President Hu Jin-o, the government is exhorting companies to transform Chi-ı by focusing on the lab as well as the factory. To make that ıppen, Beijing has pledged to boost funding. In the late '90s, hina spent less than 1% of gross domestic product on re-:arch and development. That figure is now up to 1.5%, but Hu ants to raise it to 2.5% by 2020—meaning outlays of $115 billion a year. "Everybody from government to individuals recognizes that [the Chinese] need to innovate," says Dan Goldstone, head of the Shanghai office for London consultant ?WhatIf! The Innovation Co.

Companies, both foreign and domestic, are taking up the challenge. From chipmaker Intel and search giant Google to AstraZeneca and Dow Chemical, multinationals are stepping up investment in R&D on the mainland. Chinese computer maker Lenovo Group and telecom equipment giant Huawei Technologies are pouring resources into cutting-edge technology. Manufacturers such as Chery Automobile are hiring top engineers to design cool new models.

Biotech startups are offering experimental therapies unavailable or prohibited in the West. Shenzhen Beike Biotechnology Co., for instance, is implanting adult stem cells in patients to treat conditions such as autism, Lou Gehrig's disease, and strokes. While some foreigners might balk, "the whole Chinese government is promoting this," says Dr. Sean Hu, a 39-year-old Guiyang Medical College graduate who earned a PhD in Sweden, did a postdoc at University of British Columbia, and is now chairman of Beike. "That is the biggest advantage we have."

> **"Whenever manufacturing is located in a country, innovation always follows"**
>
> *–Vince Feng, Hong Kong-based managing director for General Atlantic Partners*

Of course, China has a long way to go. While the Chinese invented gunpowder, paper, and the compass, since the decline of the Qing Dynasty China has taken a backseat not only to Western nations but also to Asian neighbors Japan and South Korea. In the eyes of many Westerners, the Chinese are outstanding manufacturers but lag behind such innovative Indian companies as software service provider Infosys Technologies Ltd. and drugmaker Ranbaxy Laboratories Ltd. Making matters worse, Chinese companies are often labeled copycats of their Western rivals. Cisco Systems Inc. sued Huawei in 2002 for allegedly stealing Cisco's router technology, and General Motors Corp. took Chery to court in 2004 for allegedly copying a GM design for Chery's popular QQ compact. In both cases, the companies settled out of court. China's schools, meanwhile, don't always turn out the kind of worker many companies want. "At Chinese universities, [students] aren't encouraged to take the initiative," says Frans Geidanus, chief technology officer for Asia Pacific for Dutch conglomerate Royal Philips Electronics. "They learn the facts, but they don't learn to be creative."

The pace of change, though, is picking up. China accounted for 130,000 patent applications in 2004 (the most recent year for which figures are available). That makes it No. 5 globally, according to figures released on Oct. 16 by the World Intellectual Property Organization, a U.N. agency. Although China was still far behind No. 1 Japan (with 450,000 patents in 2004) and No. 2 U.S. (with 403,000), its 2004 patent applications were six times the number in 1995.

China boosters are betting that the country can fast-track the makeover of its economy. "It's inevitable that [the mainland] will become an innovation center," says Vince Feng, Hong

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Kong-based managing director for General Atlantic Partners, a U.S. private-equity fund that has invested $48 million in Beijing Internet company Oak Pacific Interactive. China has history on its side, Feng argues. "Whenever manufacturing is located in a country, innovation always follows," he says, pointing to the British, Americans, and Japanese as examples. "Manufacturing has migrated to China and is there to stay."

Intricate Fabric

TAL APPAREL LTD. highlights the link between manufacturing and innovation. The Hong Kong clothing maker, with production and R&D operations on the mainland, has prospered in the past 50 years. But today, the $720 million company is trying to survive in a fiercely competitive industry by pioneering new fabrics such as cotton cashmere and washable wool, and it is working with a mainland partner to develop the textiles necessary for new products. "There's a lot more science than you think in making clothes," says Managing Director Harry N.S. Lee.

China's health challenges also help to spur ingenuity. The country's status as an incubator of deadly viruses is a powerful motivator, says Yin Weidong, the 42-year-old founder of Beijing's Sinovac Biotech Ltd., the mainland's leading producer of vaccines. The Tangshan native studied infectious diseases in the 1980s as a doctor for China's Centers for Disease Control & Prevention. In 1992, Yin started the company that eventually became Sinovac and developed the country's first hepatitis A vaccine. More recently, Sinovac scientists helped other Chinese researchers develop a vaccine against SARS, the respiratory disease that spread across the mainland in 2003. "With hepatitis, there was a lot of information available, but SARS was completely new," says Yin. "We didn't even know the characteristics of the virus or if a vaccine could be made."

The experience helped prepare Sinovac for its next challenge: an avian flu vaccine the company is developing. It's unclear whether the disease will spread worldwide, but in China it's a real threat that has killed 14 people, lending urgency to Sinovac's efforts. "If SARS and avian flu...become problems in the West, people will find that Sinovac is the company talk to," says Yin.

While foreigners might well benefit from China's innovatic push in the event of an avian flu outbreak, mainland researche are already gaining from increased contact with colleagues ove seas. John Deng, 38, founder of chip designer Vimicro Cor has a PhD from the University of California at Berkeley a worked for IBM before returning to China in 1999 and launc ing Vimicro, a successful designer of chips for PC cameras. Ot er Vimicro executives have PhDs from the U.S. or have work there, and today the company has partnerships with Intel, M crosoft, and Texas Instruments. "You really need to be inte acting with the Sonys, the Hewlett-Packards, and the IBMs make sure your innovation is state-of-the-art," Deng says.

China's universities are getting a helping hand from the mul nationals, too. Not long ago, professors, strapped for fundir were abandoning school and entering the business world. The was even a popular expressi for giving up on the ivory to er: "jumping into the sea."

There's little need to b anymore, says Tao Linmi, associate professor in t department of computer s ence and technology Tsinghua University. Ta main project is a cam system that follows mo ments and gestures, au matically keeping an ima in camera range. He's wo ing with engineers from Intel research center in B jing and is collaborat with nearby R&D cent run by France Télécom a NEC. He says he's happy see others join the cro "Google's research cer just opened outside gate," he says with a g "More research instit mean more funding for Without foreign money, says, his work wouldn't h advanced nearly as muc it has. "Five years ago, usually published in nese journals," he s "Now we are in internati al journals."

Western companies helping Chinese knowle workers think more atively. Nokia Corp., for stance, relies increasingl Chinese engineers. The jing Product Creation Ce is one of just four R&D for handsets that Finnish phone maker o ates worldwide. Run the Beijing lab, w opened in 2003, was diff

INTEL CHIP Made at its plant in Sichuan

On the Cutting Edge

Chinese innovators are making a mark

AUTOS

» Chery Automobile's QQ compact is a huge success, even though GM accused Chery of copying the design (the dispute was settled out of court). Now, Chery is hiring top engineers to design more innovative cars.

BIOTECH

» China is experimenting with treatments not possible elsewhere because of safety or ethical concerns. In 2003, SiBiono GeneTech launched the first commercial gene therapy product, a cancer drug called Gendicine.

COMPUTERS

» Since buying IBM's PC division last year, Lenovo has become the world's No. 3 PC company. Now, its big innovation team in Beijing is helping the company introduce smart new products.

ENERGY

» As oil imports soar, Beijing is pushing alternatives such as solar energy. Suntech Power, China's No. 1 producer of photovoltaic cells, plans a $60 million R&D center in Shanghai.

SEMICONDUCTORS

» Beijing is helping to spur the development of local chip design shops such as Vimicro. The company, founded by returnees from the West, is the world's No. 1 designer of semiconductors for PC cameras.

TELECOMMUNICATIONS

» Huawei Technologies has settled accusations that it stole Cisco's ideas to make routers. Now, Huawei is building a solid R&D team, with labs in China, India, Sweden, and the U.S.

Data: *BusinessWeek*

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at first, says chief Steven P. Marcher. The engineers were very bright, he says, but they didn't know how to navigate a corporate culture that emphasized innovation. "They were always dependent on me telling them what to do," he recalls.

So Marcher developed a training program to encourage Nokia's Beijing managers to "think for themselves." The cultural obstacles were daunting. "It's a completely new way of thinking compared to a Chinese company," says Marcher. "They are coming from a hierarchical setup to one where I am fully empowering my team to take control." The yearlong class, involving coaching and mentoring aimed at developing lead ership skills, has produced impressive results, Marcher say Last year, the Beijing center was the driving force behind fou new Nokia models, which Marcher's Chinese engineers pr duced in 12 months—a very short time by Nokia standard "We broke all sorts of records," he says. And, he boasts, "ever thing was done from Beijing."

BusinessWeek online For a slide show on China Inc.'s innovation leaders, please go to www.businessweek.com/extras

A Growing Cadre Of Code Warriors

WISHING BONE: His contest winnings top $200,000

MEET "WISHING BONE." THAT'S THE ONLINE HANDLE OF Wu Jiazhi, a student at Zhejiang University who has become a big winner in the programming contests offered by TopCoder Inc., a Glastonbury (Conn.) company that works with the likes of America Online and Merrill Lynch. Topcoder invites programmers around the world to solve software problems over the Net. Within weeks of entering his first contest three years ago, Wu had bagged $2,500. "I bought my first laptop with that money," says the 26-year-old. After earning $200,000-plus from TopCoder since then, he now has enough cash to buy plenty more computers.

With programmers like Wu faring so well, the world is reassessing China's software industry. For years, multinationals such as Microsoft Corp. watched almost helplessly as Chinese consumers and corporations alike pirated their software. But the climate is improving as Beijing cracks down on intellectual-property violations. Although piracy remains a severe problem, "we've made a lot of progress," says Ya-Qin Zhang, the Beijing-based head of China research and development for Microsoft.

The Chinese government is hoping better training will also bolster the fledgling industry. In 2002 it launched software colleges at dozens of universities, with a focus on satisfying the needs of businesses. Today, there are 36 such schools in China, which have graduated a total of 60,000 students in the past three years. "Software colleges want to train talent for industry, not for academia," says Jack Wu, deputy dean of the software college at Peking University.

Topcoder is taking advantage of the deepening talent pool. President Robert Hughes says he's impressed by the quality of software engineers in China, which is home to more than 40% of the programmers taking part in TopCoder competitions. Overall, China ranks third in TopCoder's software contests, well ahead of rival India. Chinese programmers "have been innovative, thinking creatively in solving the problems we put out there," he says. TopCoder is now opening an office in Beijing, its first outside the U.S., to recruit more Chinese.

Don't expect all of them to pull down the kind of money Wishing Bone has earned. "Assistant" is more typical. He's Wu Yanbo, a 24-year-old graduate student at Tsinghua University in Beijing who has taken home $5,000 in the contests since last December. That's enough, though, to make him consider dropping out of school, something that doesn't go over well with his parents. Older Chinese "think the only way students in China can have a good career is to get an advanced degree," Assistant says.

Wishing Bone wants to quit his studies, too, and he tries to reassure his worried parents that there's life after graduate school. Exhibit A: famous American dropouts such as Bill Gates, who gave up on Harvard University to start Microsoft and today is the world's richest man. "They told me: 'That's America, not China,'" he says. Will Wishing Bone listen to his parents and stick with his degree program? "Probably not," he says. With China's software industry on the rise, he and other smart young programmers see plenty of opportunities beyond the university gates. *–By Bruce Einhor*

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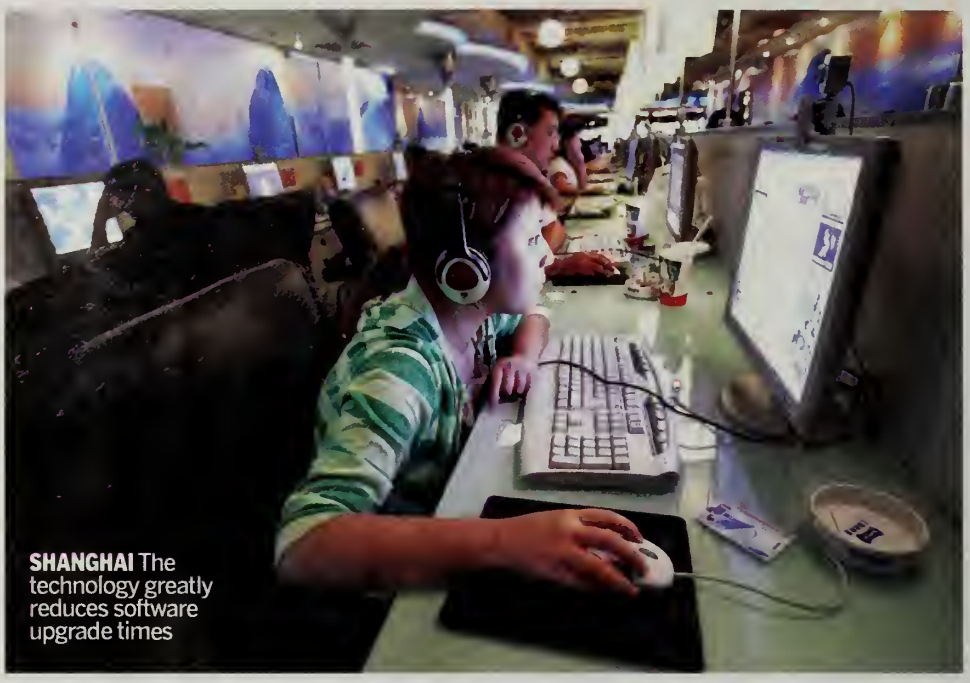

SHANGHAI The technology greatly reduces software upgrade times

In China's Net Cafés, Intel Pours It On

Its locally designed new system caters to a booming market

SOME 11 MILLION PCs IN OVER 110,000 INTERNET CAFES. IF you're Xu (Ian) Yang and your job is to sell Chinese on using computers with Intel chips, those numbers will surely grab your attention. In late 2003, Yang, the Beijing co-general manager of Asia-Pacific for Intel Corp., was in the northeastern city of Harbin to speak to university students. It was a typically frigid northern day, and since Yang had a little time to spare, a staffer suggested they warm up in an Internet café.

While China's Net cafés had a reputation as seedy firetraps, this one impressed the Intel team. It was filled with students playing online games, watching movies, and instant messaging their friends. "There had to be 500 people there on three floors," recalls Yang. If there were so many PCs in just one café, what sort of opportunity might exist nationwide? "I said to the guys: 'Come up with data on this,'" says Yang.

It wasn't easy. Many cafés operated without licenses, so numbers were sparse. But Intel's team tracked down encouraging figures from the government: At that time, China had 110,000 Internet cafés, with an average of 100 PCs each, for a total of 11 million. Intel's reaction? "We went, 'wow, this is an industry,'" recalls Yang. Because cafés cater to Chinese gamers who want to play the most up-to-date games, owners replace their PCs every two years or so. That amounts to about 6 millio PCs per year. Yang realized h needed a strategy for Net café "How do we serve that market? he asked.

The answer came a few month later in a Beijing traffic jam. Stuc in the car were Minerva Yeun who had recently transferred fro Silicon Valley to Intel's Shangh research and development cente and two other Intel executive "We understood there were a lot pain points for the owners," sa Yeung, a Xiamen-born Princeto University PhD who is now 3 While the car crept forward, t three started brainstorming, a before the drive was over they d cided they ought to focus on ma ing it easier for café operators manage and update their comp ers. They also wanted the techn ogy to be more affordable than t advanced designs that big corporations use for maintaini their thousands of PCs.

A team of engineers soon put together a prototype. But I tel's China operation had never come up with a new prod from scratch, and it was difficult for the Net café group to fi a champion within the company. A breakthrough came in Se tember, 2004, when the team took Paul S. Otellini—today tel's CEO but then its chief operating officer—to a café Shanghai and sold him on the concept. "We could see it was ing to be something huge," says Robert Liu, a 36-year-old so ware engineer from Taiwan. Intel launched the first version e ly in 2005 and has already updated it twice.

It's a big time saver for café owners. The system cuts ma tenance costs by 78% and reduces software upgrade times 85%, Intel says. The company is working with local PC mak such as Lenovo and Haier as well as component suppliers fr Taiwan to build interest in the technology, and it hopes to 1 million computers with it this year. But many café own working on thin margins aren't interested in buying pricier tel machines if they can spend less on cheaper PCs now. "C na doesn't fully understand support and service," says O'Donnell, a marketing director in Intel's Shanghai office.

What the Chinese do understand is price. While the systen self adds just $1 to $2 to the price of a PC, Intel's machines roughly 15% more than computers equipped by Advanced M Devices Inc., which has launched a Net café product of its o That has helped AMD break Intel's erstwhile lock on China, the smaller rival has captured some 20% of the market. Tha problem because China remains crucial for the company: I last year sold $5.8 billion worth of chips there, or 8.5% o 2005 revenue, according to market researcher iSuppli Corp

Intel acknowledges that selling operators on the system easy. So company engineers are trying to make the chips mor luring, for instance by reducing power consumption (electr is the No. 2 cost for café operators, after rent). For Intel, the café system proves that its Chinese engineers can come up innovative products. Getting Chinese consumers to embrace innovation may turn out to be the bigger challenge. ■

–By Bruce Ein

> > >

Some folks barbeque for fun. Others do it for a living. Something they all share are tough standards for the ribs, pork shoulders and boneless loins they use. Cargill learned from chefs and grocers that people want more flavorful pork that cooks up tender and juicy. We developed it using special feeds, growing processes and selection techniques. Barbeque enthusiasts say they like the new pork. What they won't tell us are their secrets for cooking it. This is how Cargill works with customers.

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The Taking of Lazard

Bruce Wasserstein finally opens up on the remaking of the venerable M&A firm

By Anthony Bianco

BRUCE WASSERSTEIN IS TRYING TO BE diplomatic—really he is—as he compares Lazard Ltd., the storied investment bank that he runs, with Wall Street giants like Goldman Sachs, Merrill Lynch, and JPMorgan Chase. But tact does not come naturally to Wasserstein, the preeminent merger-and-acquisition tactician of the rough-and-tumble 1980s.

"People get upset if you deprecate anybody, and I don't want to," says Wasserstein, chairman and CEO of Lazard, which more or less invented M&A as an investment banking specialty during the 1960s and 1970s heyday of Felix Rohatyn. "But we're sort of in a group by ourselves when it comes to the quality of the advice we provide. Quality is not the focus of a lot of our competitors because having lots of capital is their focus, or lending capital, or whatever it is."

Even the many enemies that Wasserstein has made in his three decades of M&A warring might concede that he is entitled at this point to boast a bit. Last year, he took the most audacious gamble of his career in committing to transform a bitterly divided Lazard into a public company. Failure could have meant professional ruin for Wasserstein, now 58, and might even have destroyed the House of Lazard, the last of Wall Street's great private partnerships. Instead, Wasserstein emerged from Lazard's initial public offering in May, 2005, with the largest stake in a company with a market cap that now exceeds $4 billion.

"Bruce took over a dying firm and totally reenergized it," says lawyer Martin A. Lipton, a founding partner of Wachtell, Lipton, Rosen & Katz and the dean emeritus of the M&A bar. "It unquestionably was his greatest deal."

The Brooklyn-born, Harvard-educated Wasserstein did much more than revive Lazard: He made it his. What long had been an investment bank molded in the image of the elite, inscrutable French families who controlled it for a century and a half is now the House That Bruce Rebuilt. "There was all this 62nd-floor intrigue going on for years," says senior banker Jim Milstein, referring to Lazard's executive floor in Manhattan's

WASSERSTEIN
Sure, he'll lose his temper—but only for dramatic effect

landmark GE Building. "The really big difference between now and when I started at the firm is that there is no question who is in charge: Bruce."

As a public company, Lazard is off to a fine start. For the first half of 2006, it posted a 72% jump in operating income, to $163 million, on a 28% gain in revenues, to $762 million. On Oct. 17, Merrill Lynch & Co. reacted to a recent decline in Lazard's transaction volume by cutting its third-quarter earnings estimate by 12%. However, analyst Guy Moskowski noted, "this downturn could simply imply a much better than expected 4Q as delayed transactions close." Since its debut at $25 a share, Lazard's stock soared as high as $49 and now trades at about $40 a share. This works out to a 60% gain over the IPO price, considerably better than the stocks of most of Lazard's larger rivals have fared over the past 18 months.

However, as a relatively pure play in M&A, Lazard is bound to suffer more than its full-service competitors when today's floodtide of mergers, acquisitions, divestitures, and restructurings recedes. It's only a question of when and how badly. Lazard has survived plenty of previous cyclical downturns in its 148 years, but never before has the firm entered one relying on an appreciating share price to inspire and unify its dealmakers. "Today, people are euphoric, but if the stock starts to suffer, a whole different dynamic will come into play," predicts the investment banking chief of a big Wall Street house.

The overarching uncertainty is whether Wasserstein will prove to be as Lazard's CEO what he long was reputed to be as a working banker: the biggest, baddest brain in the deal game. No one doubts Wasserstein's smarts, but his penchant for bold, attention-grabbing moves can backfire—as did his decision a year ago to align Lazard with Carl C. Icahn in the buccaneering billionaire's quixotic campaign against Time Warner Inc.

What's more, despite Wasserstein's herculean efforts over th last five years, the new Lazard has yet to prove that it can d more than hold its own against the big banks. "Lazard's rev enue line has grown as it's participated in the global M& boom, but Bruce really hasn't done anything to fundamentall change Lazard's place in the world," says Steven Rattner, a for mer M&A banker and a top Lazard executive who left t found the private-equity firm Quadrangle Group in 2000.

EVEN IN PINSTRIPES, Wasserstein comes acros less like a deal man than a college professor o Wall Street sabbatical. He speaks in a deep, im passive baritone, unspooling business analys from his overstuffed cranium as portentously a Henry Kissinger dissecting a foreign policy is sue. He is dismissive of sloppy thinking and ca be brusque even with close associates, but h loses his temper only for dramatic effect. "I' certainly seen him act angry, but I always knew it was an act says Alan C. Stephenson, a partner in the law firm Cravat Swaine & Moore who has worked with Wasserstein on dozen of transactions since the late 1970s.

Wasserstein was an M&A banker of such domineering pre ence in the 1980s and 1990s that competitors stuck him wi the nickname "Bid 'Em Up Bruce" for his supposed Svenga like ability to induce clients to pay top dollar for acquisition And yet he runs Lazard with a surprisingly light touch from a enormous, art-filled office high atop the GE Building. "He a ways retains the string of authority, but he reluctant to jerk it," says Jeffrey A. Rosen Lazard deputy chairman and longtim Wasserstein associate.

Many Lazard insiders say that Wa serstein's essential achievement—the o that made the IPO possible—was his repo ulating of the investment bank's deplet senior ranks. Lazard now employs 127 ma aging directors in M&A and 43 in investme management, up from 85 and 19, resp tively, in 2002. Wasserstein had to throw lot of money around to attract top talent. B he also made Lazard a refuge for veter dealmakers demoralized by the one-size-fi all commercial imperatives and bureaucr ic constraints of the big houses.

One of the most productive newcom has been Garry W. Parr, who left a lofty pe at Morgan Stanley to join Lazard in 20 Parr once co-headed Morgan's M&A depa ment with William M. Lewis Jr., who q Morgan and joined Lazard a year after P did. Parr, 49, and Lewis, 50, joined Laz on the condition that they not have to m age anyone but their secretaries. "Lazard fers senior bankers the opportunity to fo on clients," says Parr, a financial-servi specialist whose many big-ticket assi ments include advising Bank One on its $ billion merger with JPMorgan Chase & C

That's because none of Lazard's dealm ers are allowed to be full-time admini tors. "The key to Lazard is you have to b

Lazard's Banner Year for **Billion-Dollar Deals**

(largest deals announced in 2006)

Lazard client	Transaction	Value (billions)
Gaz de France	merger with Suez	$47.4
Caisse d'Epargne	merger to form Natixis	30.0
SuperValu	acquisition of Albertson's	17.4
Pfizer	sale of consumer division	16.6
Cerberus	purchase of stake in GMAC	14.0
Fisher Scientific	merger with Thermo Electron	12.8
Key Span	acquisition by National Grid	11.8
Caisse d'Epargne	partnership with Caisse des Depots	10.8
TV PLC	rejection of consortium approach	9.5

Data: Lazard Ltd.

JACOBS In the end, Lazard's dealings with Icahn were Wasserstein's decision

> "The key to Lazard is you have to be a player-coach. You have to have clients and be involved in big transactions. Otherwise, you get no respect."
>
> —Kenneth M. Jacobs

ayer-coach," says Kenneth M. Jacobs, a deputy chairman who ads Lazard's North American banking effort. "You have to ve clients and be involved in big transactions. Otherwise, you t no respect."

Wasserstein runs the investment banking side of Lazard rough a single committee with 16 members that meets once week in New York, with the firm's vital Paris and London of- es participating through a videoconference linkup. "Goldman chs is a terrific organization, but we're like the polar oppo- e," Wasserstein told *BusinessWeek* in his first extensive inter- w since he joined Lazard in 2002. "We don't like committees, ere are no 8 o'clock meetings, there aren't a lot of layers of ructure. It's a client organization, basically. It's more like the ructure of a law firm."

Although Wasserstein displays a nuanced understanding of ues of personnel and organizational structure, he doesn't cir- late much within Lazard. This is one boss who wouldn't be ught dead in the hallway exchanging pleasantries or high- es. He is rarely seen even in the partner's dining room, where the senior staff shares buffet meals around a big rectangular table seating 14.

Wasserstein spends a lot of time on the road, meeting with corporate executives and government officials and, in his words, "creating a portfolio of long-term relationships." He tracks all of Lazard's M&A assignments but rarely acts as lead banker and takes an active role in other people's deals only when asked to by a colleague. "Bruce is prepared to be helpful if you want his advice or want him to meet someone, but he does not interfere," says Frank A. "Terry" Savage, a banker who is Lazard's main contact with the hedge fund community.

Wasserstein spends much time alone in his office, pondering refinements in the strategic course he has set. Even as he departed radically from tradition in converting Lazard to public ownership, he maintained a business model of ancient Wall Street vintage. As before, Lazard minimizes activities that require putting capital at risk, including trading, underwriting, and merchant banking. Instead, it concentrates on M&A, with a sideline in investment management. This approach is at once

ultraconservative and boldly contrarian, in that Lazard is proposing to live off advisory fees in an investment banking industry that makes most of its money wielding massive sums of capital for the house account.

Lazard's resurgence highlights an important countertrend: the proliferation of M&A boutiques such as Greenhill & Co., Evercore Partners, and Perella Weinberg Partners. M&A specialist houses advised on 55% of the 20 biggest deals announced in 2005, nearly twice as many as in 2000, according to Thomson Financial.

Although Lazard is a fraction of the size of a Merrill Lynch or a Morgan Stanley, it is no boutique. With a banking staff of 907 deployed in 29 offices around the world, Lazard is solidly ensconced in the second tier of M&A departments. The $778 million in fees it pocketed in 2005 ranked it seventh worldwide, just behind Merrill ($882 million) and ahead of Lehman ($766 million), according to publicly disclosed data. Goldman, Sachs & Co. led the list at $1.9 billion. Greenhill & Co., the largest of the M&A boutiques, took in $142 million.

In a megamerger, a Lazard or a Greenhill typically is hired to complement the full-service houses, not supplant them. "The trend is toward multiple advisers, because what happens is the CFO says, 'I need Big Bank,' and the CEO says, 'Wait a minute, I actually need some advice...,'" Wasserstein says. "We're trying to offer service that is premium in terms of thoughtfulness, and not the golf outing, the salmon fishing, the seminar in Vegas, or whatever else people do."

> "We don't like committees, there are no 8:00 meetings.... It's more like the structure of a law firm."
>
> —Bruce Wasserstein

Although Lazard's rivals scoff at Wasserstein's claims of superiority, the Lazard name still carries a certain cachet in corporate circles. Joel F. Gemunder, the CEO of Omnicare Inc., already had completed 100 acquisitions in building his company into America's largest supplier of pharmaceuticals to nursing homes. But when Gemunder pressed a $1.8 billion hostile bid on NeighborCare Inc. last year, he decided not to rely solely on Omnicare's usual investment bank, Lehman Brothers.

"I'd heard that Lazard was very astute in complex transactions," Gemunder says. "I also knew that this was a situation that would require some statesmanship, as well as the normal investment banking things."

Omnicare's acquisition of NeighborCare is one of a host of unusually difficult, contentious assignments that Lazard has completed as a public company. Its bankers delved so deepl into the horrific mess that was MCI Worldcom during its bank ruptcy restructuring that they were "about as much in our man agement group as anyone actually in management," say Michael D. Capellas, MCI's former CEO. Wasserstein and tear also helped the board of Hollinger International Inc. outwit it ingeniously conniving CEO, Conrad Black, and transform th scandal-ridden company into the Sun-Times Media Group In

On the other hand, as CEO of Lazard, Wasserstein also mad what probably was the biggest and certainly the most perple ing misstep of his career: siding with Icahn against Tim Warner, the world's largest media company and a Wasserstei client of long standing.

Wasserstein began working with Time Inc. in the early 198 and was a key adviser in its 1989 merger with Warner Com munications. Over the past 15 years, Tim Warner estimates that it has paid abo $30 million in M&A advisory fees Wasserstein. However, the paymen trickled to a halt after Richard D. Parso succeeded Gerald M. Levin as CEO 2001. Although Parsons admires Wasse stein as a provocative thinker, other seni Time Warner executives consider hi overbearing.

In the first half of 2005, Icahn laid o $1 billion to buy 1.5% of Time Warne shares and began calling on Parsons take various steps to boost the compan moribund stock. After a few months of a itating failed to move the stock or attra support from other big shareholde Icahn turned to Wasserstein, apparen in hopes of adding intellectual heft to his arguments. He agre to pay Lazard $5 million to produce a report on how best boost Time Warner's market value, and promised $6.5 milli more for every $1 that the company's stock rose above $18.

Virtually the entire senior brain trust of Lazard joined compiling the report, with Wasserstein acting as a kind of se ior editor. In February, Wasserstein took the stage in a crowd Manhattan hotel ballroom to personally present *The Lazard R port*, a 343-page argument for busting up Time Warner i four pieces. The tome landed on the Street with a thud. T fund managers at whom it was aimed found it so lacking fresh, compelling ideas that Icahn sent up the white flag very next day. (Icahn did not return calls seeking comment.

Icahn quickly negotiated a ceasefire with Time Warner a

s continued to add modestly to stockholding as Parsons' gged implementation of his n strategic plan finally has shed the share price above 9.50. Lazard may be due anoth- check from Icahn, but Wasser- in can cross Time Warner off his ent list. "We're unlikely to hire zard in the future, but not be- ise of any bad blood," Parsons s. "It's not personal, it's busi- ss. But in business you choose ur relationships and your allies." Wasserstein's comeuppance— "tarnishing of his mystique," one foe puts its—delighted ny of the rivals whom he has sted over the years. "This was as barrassing for Bruce as some of victories were for his opponents," gloats a top executive at e of the big full-service firms.

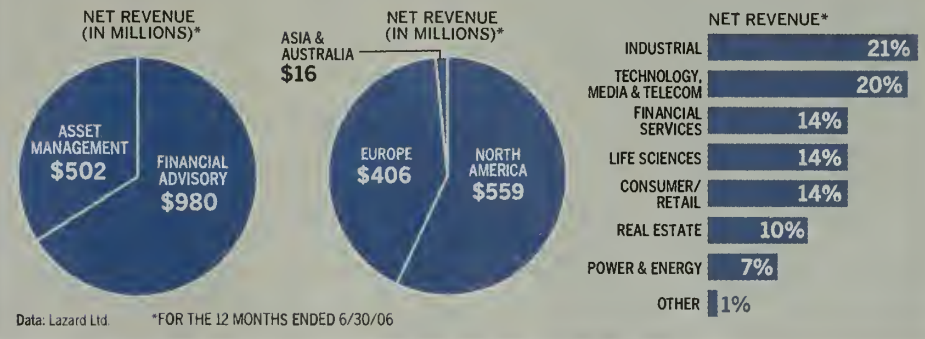
But even Wasserstein's friends were left pondering the ques- n, What was Bruce thinking? Why run the risk of appearing th disloyal and misguided by taking up the cause of a self- ving dissident who appeared to have so little chance of suc- ss? Wasserstein's basic explanation is that Time Warner ought out his inner activist. "I care about Time Warner, hich is peculiar, but which is probably why we did this," he ys. "It was some sense that I wanted to see change and felt strated about it."

This statement prompts a knowing chuckle from a Wasser- in pal who is himself a longtime M&A adviser. "I also think uce was pissed off because he hadn't gotten any business m Time Warner in a long time," he says. "Bruce isn't stupid. knew he was taking a risk. I wouldn't have taken it myself, t I do admire the boldness of it."

Many of Wasserstein's colleagues also were averse to taking is risk. The issue was hotly debated within the senior ranks fore Lazard accepted the Icahn assignment. "It was fully ed, so it was not as if Bruce didn't know all the pluses and inuses," Jacobs says. "In the end, it was his decision."

If there is a silver lining to the whole Time Warner debacle, s that the partners who originally disagreed with Wasserstein pear to have closed ranks behind him. Even the strongest- lled Lazard bankers seem not merely to tolerate Wasserstein's thority but to welcome it as an antidote to the incessant in-

The House that **Bruce Rebuilt**



fighting that long afflicted Lazard under its former chief partner, Michel David-Weill, and finally climaxed with the IPO.

David-Weill, now 74, is a charming, imperious Frenchman who had run Lazard since the mid-1970s and whose family had owned a controlling interest in it for four generations. Actually, the Lazard empire consisted of three separate investment banks controlled by the David-Weills in concert with various other investors: Lazard Frères & Co. in New York, Lazard Frères et Cie in Paris, and Lazard Brothers in London. All the Lazard houses were cut from the same *haute banque* cloth, but competed as much as they collaborated.

OVER THE YEARS, David-Weill had sabotaged several succession plans of his own devising, spreading disarray and discontent through the ranks. He did manage to combine the three Lazard houses under common ownership in 1999, but it was too little too late to bring harmony. By 2001, so many partners had quit and taken their clients with them that David-Weill tried to entice Lehman Brothers Inc. into merging with Lazard.

After the terrorist attacks of September 11 closed off this possibility by forcing Lehman to vacate its Lower Manhattan headquarters, David-Weill turned—or returned—to Wasserstein. In the mid-1980s, Lazard's chief had tried to lure Wasserstein away from First Boston, where he ran M&A with Joseph Perel-

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la. Wasserstein declined the offer, but so admired Lazard that when he quit First Boston in 1988 with Perella to form Wasserstein Perella & Co. (WP), he declared that his ambition was to build "the Lazard of the 1990s."

WP was both far short of this lofty goal and well past its peak when Dresdner Bank acquired it in 2000 for $1.4 billion—$600 million of which went to Wasserstein. He moved to London to take a senior position with the German bank, but his hopes of using its balance sheet to build a top-tier investment bank were soon dashed when Allianz Group acquired Dresdner itself.

Wasserstein was eager to return to Wall Street, but on his own terms. In late 2001, David-Weill signed a contract surrendering to him something he had never granted any previous would-be successor: full executive authority, with the title of "head" partner. As part of the deal, Wasserstein invested $30 million to share in the ownership of Lazard along with David-Weill and a tight-knit group of other, mostly Parisian investors collectively known as "the capitalists."

The new head partner lured scores of experienced M&A bankers away from other investment banks using tens of millions of dollars in profits that otherwise would have been paid out to David-Weill and his fellow owners. The capitalists vehemently objected to their sudden loss of income, ganging up on Wasserstein at board meetings. Their anger was exacerbated by frustration, Wasserstein's contract having rendered Lazard's board all but impotent on issues of budget and personnel.

"You'd go to a board meeting and it was entirely Michel guys," Wasserstein recalls. "They'd say, 'We don't like hirir new people.' I'd say, 'Well, thank you very much.'" (David-We did not respond to interview requests.)

Wasserstein's aggressiveness also discomfited many of tl veteran bankers who remained at Lazard. "If you are mediocre banker, you have no place here," the new head d clared at his first staff meeting, stoking fears among the o guard of a wholesale purge of their ranks. In London and Par partners also worried that Wasserstein's heavy emphasis c cross-border and transatlantic teamwork was his way of subj gating the European offices to New York.

Wasserstein's ability to fire as he hired was limited by the si deals David-Weill had cut over the years with certain favor partners. This was most frustratingly the case at Lazard Ass Management (LAM), the money management arm. Wasserste believed it desperately needed new leadership and stepped i investment in staff and new products, but the two executiv who had founded the business in 1982 were locked into co tracts entitling each man to 15% of LAM's profits through 20C Disaster struck a year into Wasserstein's tenure wh William A. von Mueffling, a budding hedge fund star, r signed in a huff. A half-dozen colleagues, $3 billion in asse and half of LAM's profits left with him.

By 2004, a quickening of M&A activity was improvi Lazard's financial outlook, and the firm's various factions we starting to coalesce around Wasserste Says Bruno Roger, a Paris-based bank who is one of Lazard's biggest produce "I was completely convinced by Bruce tl it was possible to transform Lazard a yet keep the things that had always ma Lazard Lazard."

In his coolly calculating way, Wass stein decided to force a showdown w David-Weill and his confreres. At a boa meeting in June, 2004, he proposed tra ferring majority ownership from the ca talists to the working partners via an I By most accounts, David-Weill initia was opposed to going public, as w many of the working bankers. They cluded Vernon E. Jordan Jr., the well-c nected lawyer and former "first pal" President Bill Clinton. "I'm wedded to h tory," says Jordan, who joined Lazard 2000 after turning down a job offer fr Goldman Sachs.

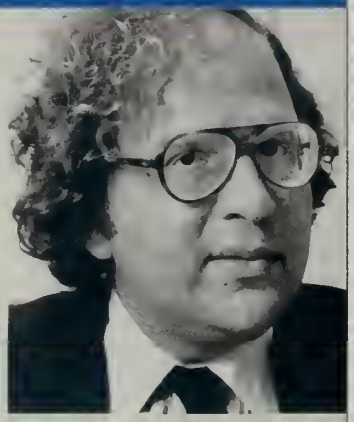
In the end, greed—and Wasserstei implacable arguments—trumped se ment. Wasserstein finally secured the sent of all but a few of Lazard's 175 m aging directors by crafting the IPO to g them 62.4% ownership of a company w an initial market capitalization of $2.5 lion. (Wasserstein got the single big slice, amounting to 11.4% of Lazard now worth $450 million.)

Similarly, he finally won over the ca talists by agreeing to pay them $1.5 lion—a giant $900 million in excess book value—and by granting the board right to fire him if the stock offering wa completed by the end of 2005. In com

BIOGRAPHY

Bruce Wasserstein

At Lazard, he's making the biggest gamble of a long, audacious career:



TITLE: Chairman and CEO, Lazard Ltd.

BORN: Dec. 25, 1947, Brooklyn, N.Y. Father owned a textile business.

EDUCATION: BA, University of Michigan, 1967; degrees from Harvard Business School and Harvard Law School, 1971.

EARLY AMBITIONS: Was executive editor of the *Michigan Daily* and worked as a summer intern for *Forbes*. But gave up journalism career to work as an associate at law firm Cravath, Swaine & Moore, 1972-77.

FAMILY: Married to Claude Becker Wasserstein. Father of five children; also raising his late sister's daughter.

M&A RESUME: Joined First Boston in 1977, later co-head of M&A with Joe Perella. Co-founded Wasserstein Perella & Co. in 1988 and was CEO until WP was acquired by Dresdner Bank in 2000.

Resigned in 2001 as executive chairman of investment banking division Dresdner Kleinwort Wasserstein.

ACCOMPLISHMENTS: Helped broker over 1,000 deals with a total value of $250 billion, including KKR's buyout of RJR Nabisco, Time's merger with Warner Bros., and Morgan Stanley's acquisition of Dean Witter.

WHY HE STILL LIKES THE DEAL GAME AFTER ALL THESE YEARS: "I like dealing with people's problems. What's nice about the M&A business is you get people at the inflection point of crisis, so you really get to know them."

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to terms, Wasserstein and David-Weill rarely spoke with one another but negotiated mainly through Steven J. Golub, a longtime New York partner whom both men trusted implicitly.

Beating the deadline handily, Wasserstein brought Lazard through the ordeal of its reinvention without serious mishap except in Italy, which has long been a vital source of profit and prestige for Lazard. Gerardo Braggiotti, a Milan-based banker and one of Lazard's brightest stars, grudgingly went along with the IPO only to resign a few months later. Three of Lazard's other eight Italian partners followed their leader out the door.

The resulting loss of business was bad enough, but Brag giotti accused Wasserstein of reneging on a promise to promot him into the new position of CEO of Europe. In his first publ comments on the matter, Wasserstein flatly denies it: "Gerard is a really talented guy, but I'm obviously not going to go an put him in charge of the French."

For Wasserstein, the strain of transforming Lazard was e: acerbated by the terminal illness of his younger sister, th

Private Equity
At Its Most Private

BY ANTHONY BIANCO

Judging by Bruce Wasserstein's rueful description of the private equity business he runs on the side as "the much-maligned W & Co.," he probably wishes that his name weren't on the door. After all, Wasserstein & Co. is to blame for the prevalent perception on Wall Street that Lazard's chief executive is as inept a deal investor as he is a talented merger-and-acquisition adviser.

In a first attempt at removing this smudge on his reputation, Wasserstein allowed *BusinessWeek* a peek inside what is one of the most private of all private-equity firms. What the record shows is that W & Co. is starting to hit its stride after getting off to a terrible start in the late 1980s. The firm "is not successful—it's extremely successful," says Wasserstein, W & Co.'s chairman and principal owner.

Wasserstein & Co. remains a pipsqueak vs. the likes of the Blackstone Group or the Carlyle Group, but its third and latest buyout fund is indeed off to a flying start. Launched in 2001 with $480 million, U.S. Equity Partners II has generated robust gains of roughly 45% a year on the $335 million it has invested to date. Through a series of refinancings, the W & Co. fund has recouped its full investment and still owns substantial equity in all five companies remaining in the portfolio.

Wasserstein & Co. is the successor to the merchant banking arm of Wasserstein, Perella & Co., which raised $1 billion in 1988 only to squander much of it on disastrous leveraged buyouts of Gateway and Yardley Group, both British companies. In 1997-98, WP gave it another go, raising $265 million for a new fund, U.S. Equity Partners I, strictly limited to stateside targets. When Dresdner Bank acquired WP in 2000, the Germans didn't want the merchant bank, and it was spun off as Wasserstein & Co.

Although W & Co. has invested across a wide spectrum of consumer industries, media investing has turned into its specialty. Its Prism Business Media unit is one of America's largest business-to-business publishers, featuring 70 trade books and 130 Web sites. W & Co. also counts among its holdings 25 legal publications, a dozen M&A and real estate titles, and a minority stake in the construction publisher Hanley Wood.

New York, the sole mass-circulation publication in the bunch, also is the only one Wasserstein owns personally, via a family trust. The magazine was not appropriate for the LBO fund, mainly because Wasserstein was loath to flip it in the usual three to seven years. "It most likely will stay with the Wasserstein family for a very long time," says Anup Bagaria, W & Co.'s vice-chairman.

In all his magazine ventures, Wasserstein employs the same basic strategy. The idea is to boost profits not by slashing editorial budgets to fit print's diminishing share of advertising budgets but rather by investing to speed the development of new sources of online advertising and other revenue.

This approach is paying quick dividends at Prism, which W & Co. acquired a year ago from Primedia Inc. for $385 million cash. Prism's operating earnings have risen 25% this year over last, thanks largely to a 55% surge in online ad revenues from the likes of *Fleet Owner* and *National Hog Farmer*.

The online take also is surging at *New York* and will hit $6 million this year, up from $1 million in late 2003, when Wasserstein bought the weekly for $55 million. Bagaria says a costly recent Web relaunch will put *New York* solidly in the black in 2007.

Wasserstein's dual role as chairman of W & Co. and CEO of Lazard creates potential conflicts of interest. For example, if the buyout firm were to acquire a company advised by Lazard, Wasserstein could invite accusations of self-dealing. "It's a nonissue," insists George L. Majoros Jr., W & Co.'s president. "There is a rigorous, bright-line separation between the firms." The last thing W & Co. needs is controversy when it is finally putting up numbers worth bragging about. ■

PRINT'S CHARMING
Wasserstein is investing heavily in magazines, confident that declining ad revenues can be offset by growth online and elsewhere

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*Based on model year 2005 CAFE average fuel-economy ratings and weighted sales for passenger-car and light-truck fleets sold in the U.S. by major manufacturers. †Civic Hybrid and Fit Sport with SMT shown. 2007 EPA mileage estimates: 49 city/51 highway, 33 city/38 highway, respectively. Use for comparison purposes only. Actual mileage may vary. ©2006 American Honda Motor Co., Inc. environmentology.honda.com

famed playwright Wendy Wasserstein, who died of lymphoma in January at age 55. Bruce assumed responsibility for raising Wendy's only child, a 7-year-old daughter. Wasserstein has two young sons of his own with his wife, Claude, and also is father to three adult children by an earlier marriage.

The once-portly Wasserstein lost so much weight in recent months that rumors began circulating that he was gravely ill. "It's just silly," says Wasserstein, who adds that he began exercising with a personal trainer to shed the pounds he piled on after joining Lazard. "I'm exactly the same weight I was 10 years ago. I go through these cycles. I am trying to be fit."

About 45 minutes into an interview, Wasserstein jumps up and walks across his office to fetch an elaborate coffee-and-ice-cream concoction melting on a table. "My secretary gave it to me," he says, attacking the drink with a plastic spoon.

"Is it your birthday?" I ask.

"No, no, it's to fortify me for my first press interview," he says, a bit sheepishly. "Oh, the horrors!"

Despite its woes in Italy, Lazard has nearly doubled its share of global M&A since 2001, essentially regaining the competitive position it had in the 1990s. At the same time, LAM has come all the way back and then some under Ashish Bhutani, a former Wasserstein Perella executive who joined Lazard in 2003. Assets grew to $84 billion from $50 billion as Bhutani began recasting LAM's U. S.-centric marketing to draw new institutional clients in Britain, Germany, and Australia.

Future growth is likely to come much easier for Lazard in the vast, fragmented investment business than in the famously cutthroat M&A field. Lazard's meager underwriting and financing capabilities put it at a disadvantage in competing with the Goldmans and Citigroups for the very largest deals. Meanwhile, the M&A boutiques will chip away from below, working their own networks to land plum assignments that otherwise might have gone to Lazard.

LAZARD DOES HAVE some distinctive advantages. Its restructuring advisory unit is the largest and busiest on the Street, thanks to both its own prowess and the big banks' inability to act as bankruptcy advisers to corporations whose bonds they underwrite and trade. In an era of galloping globalization, it also helps enormously that Lazard is still seen in France and Britain as an indigenous firm, not as a Yankee interloper.

In Europe especially, Lazard is still making opportunistic, high-profile hires. Wasserstein just recruited Gerd Hausler, a German investment banker who has held high positions with the International Monetary Fund for the past five years. Hausler, 55, will work mainly as an adviser to governments, a banking specialty that Wasserstein considers ripe with opportunity.

At the same time, Lazard continues to methodically enlarge its M&A franchise by filling in the gaps in its industry coverage. It has prospered particularly in building a utilities practice from scratch and by parlaying its traditional strength in pharmaceuticals (Pfizer Inc. is a longtime client) into a strong international position in biotech. In the past six weeks alone, Lazard advised Belgian pharma giant UCB on its $5.5 billion acquisition of Schwarz Pharma and represented Gilead Sciences in its $2.5 billion buyout of Myogen.

Lazard also has found clever ways to infiltrate the U.S. au industry, long a bastion of Goldman and other full-service firm Instead of going hard after General Motors Corp. and Ford M tor Co., a handful of Lazard bankers concentrated on buildi relationships with auto parts suppliers and with the Unit Auto Workers—an unconventional approach that has broug rich rewards over the last year.

Lazard advised the UAW on its $15 billion health-care settl ment with GM and continues to couns the union in its negotiations with Fo Chrysler, and Delphi Corp. The investme bank also is lead adviser to Collins & Ai man, Tower Automotive, and Meridi Automotive Systems as these large au parts makers reorganize under the ban ruptcy code. And when chassis and tra mission parts maker Metaldyne need help on its $1.2 billion sale to Asahi T Corp., CEO Timothy D. Leuliette's first c went to Lazard. "They know this to [Detroit] and are very engaged in au parts," Leuliette says.

> "Bruce is prepared to be helpful if you want his advice or want him to meet someone, but he does not interfere."
>
> —Frank A. "Terry" Savage

Jim Milstein, who co-heads Lazard's structuring practice, decided in early Se tember that it was time to start romanci Ford's top management. Vernon Jord offered to call William Clay Ford Jr., who did not respond. Wh Ford announced on Sept. 5 that he was ceding his CEO positi to Boeing Co.'s Alan R. Mulally, Jordan didn't feel so bad. J dan, a current or former director of 15 corporations, once terviewed Mulally for an open directorship at Callaway Golf Says Jordan: "At some point I will pick up this phone and Alan Mulally, and he will at least answer it."

Wasserstein also is trying to win more business in comp tion with bigger rivals by clarifying Lazard's amorphous m agement structure in Europe. In September, Wasserstein p moted Georges Ralli, 58, Lazard's Paris chief, to the new pos CEO of Lazard Europe, the job Braggiotti wanted. Willi Rucker, the 43-year-old head of Lazard London, was nam deputy CEO for Europe. "The challenge is to try to run Eur as a European business without losing the advantage of tional character," Ralli says.

Lazard's business model is as unforgiving as it is elemen for an investment bank that traffics only in advice must unf ingly show itself to be smarter than its clients and its comp tors alike. His Time Warner gaffe notwithstanding, Wasserst is immodestly confident that he and his colleagues will m this challenge. "I'm not saying that at Brand X there ar smart people," Wasserstein says. "But we literally have mu ples of the talent of other places."

Lazard Up Close

Bruce Speaks: For a Q&A with Bruce Wasserstein, go to www.businessweek.com/extras

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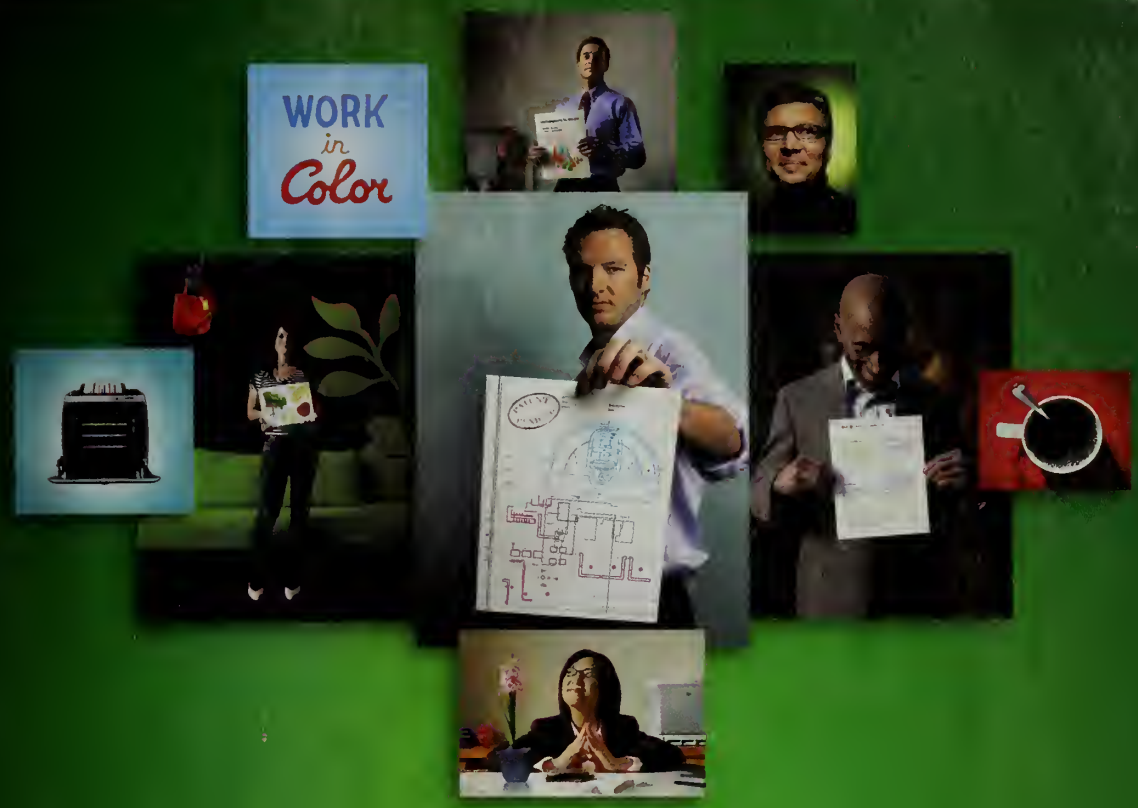

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Boom! Bu

Check the history of housing busts. Some areas bounce back more strongly than others

BY PETER COY

HOUSING HAS GONE from a sure thing to a complete muddle. Median prices fell nationwide for a second straight month in September, the first time that has happened since 1990, according to a report on Oct. 25. Homeowners don't know whether to sit tight or bail. They have no idea whether they're experiencing the beginnings of a deep bust that will leave a permanent hole in their wealth, or a small hiccup.

There's a lot to learn from history. While national downturns in home prices are rare, we have plenty of experience with busts in local markets. Remember, many regions that have been strong in recent years, such as New York, Boston, and Los Angeles, were mired in slumps in the early or mid-1990s. People who bailed out of them at the bottom are still kicking themselves or blaming their ill-informed spouses.

HOUSING WATCH

How common is this boom-bust-boom pattern? Over the past three decades about 40% of housing busts in big metro areas have eventually been followed by strong recoveries (table, page 68). That's according to a *BusinessWeek* analysis of inflation-adjusted housing prices. In an additional 15% of markets, prices adjusted for inflation barely got back to their previous peaks after 15 years. In the remaining 45% or so of markets, prices adjusted for inflation were still down a decade and a half after their pre-bust peaks.

The disparity between winners and losers was striking: Among the winning markets, the average

t!
Boom?

JOHN KUCZALA

inflation-adjusted gain after 15 years was 43%, while among the losers the average inflation-adjusted loss was 19%.

How do you know if your own local market is the kind that will snap back or the kind that will languish indefinitely? One key factor is the ease or difficulty of building new homes. Places where new home construction is a long and expensive process, such as Boston and San Francisco, tend to experience big price movements, both up and down. "Restricted supply leads to more volatility in prices," says Edward L. Glaeser, a Harvard University economist who has studied big-city housing markets.

Glaeser isn't ready to predict where prices are headed market by market, but the cities with tight housing do usually boom again after a bust. In places such as Atlanta and Houston, by contrast, price cycles are usually mild, because the supply of housing is flexible. Traditionally, flexible markets have gone through booms and busts only when there was a wrenching change in demand, such as during the oil-patch roller-coaster of the 1980s.

If the supply-side analysis is correct, it has scary implications for markets like Miami, Phoenix, and Las Vegas, where prices have zoomed in the past several years (table, page 69). Because it's easy to keep up with rising demand by building housing in those areas, they never experienced soaring prices—until the past few years, that is, when prices seemed to rise out of line with fundamentals. Speculation appears to be the culprit. Regarding Las Vegas, Harvard's Glaeser says: "I cannot believe

that this stuff is remotely sustainable."

Looking at the supply side's effect on boom-and-bust behavior isn't the usual way of assessing housing prices. The more common approach is to determine, by measures such as price-to-income ratios, which markets seem to be overvalued and which undervalued, and then assume they will converge toward fair value. Moody's Economy.com Inc. has a projection of house prices out to 2015 that shows most of the biggest 10-year gains in apparently cheap markets such as Pittsburgh, Nashville, Houston, St. Louis, and Austin. The forecaster projects small gains for expensive markets including San Diego, Los Angeles, Las Vegas, New York, and Washington.

Economy.com's approach is consistent with textbook economics. But it would have done a bad job of predicting what happened in the past 10 years, wherein the pricey got pricier and the cheap cheaper. For example, even though Houston has had a long stretch of healthy growth, it's so easy to build homes there that inflation-adjusted prices are still 19% below their 1983 peak.

With apologies to the mainstream, the truth is that supply considerations can cause markets to diverge from what seem to be the fundamentals for a long time, perhaps permanently. One explanation for this is the "superstar cities" concept developed by economists Joseph E. Gyourko and Todd M. Sinai of the University of Pennsylvania's Wharton Scho and Christopher J. Mayer of Columbi Business School. They argue that certai cities—Boston and San Francisco, say- benefit from a winner-take-all phenome non that separates them from also-ran People all over the world want to ow homes in Boston and San Francisco, an the supply is limited. As worldwid wealth rises, there is a bidding war fo homes there. No such luck for, say, S Louis. In fact, according to the author the gap between prices in San Francis and the national average doubled b tween 1970 and 2000.

In an era of globalization, cities with i ternational reputations can get an ed over blander neighbors if they're pe ceived as scarce commodities. For exan ple, Nashville, as the capital of count music, has at least the potential to conve its fame into wealth, says Gleb Nechayev, an economist at Boston-base Torto Wheaton Research, a unit of C Richard Ellis. Miami developers ha parlayed the city's international fame in booming sales of condos to Latin Ame cans and Europeans. But while t uniqueness phenomenon may he growth in those cities, it won't necessar

What Happens After A Housing Bust

About 40% of the big metro areas that suffered housing downturns over the past three decades came back and exceeded their pre-bust peaks within 15 years*

WINNERS	FLAT	LOSERS
NUMBER OF MARKETS		
9	3	10
AVERAGE PERCENTAGE CHANGE IN INFLATION-ADJUSTED PRICES 15 YEARS AFTER PRE-BUST PEAKS		
43%	0%	–19%
EXAMPLES		
NEW YORK, LOS ANGELES	CHICAGO, PHOENIX	HOUSTON, DETROIT

*We define a bust as a decline of 20% or more over five years in inflation-adjusted prices of single-family homes, based on the Office of Federal Housing Enterprise Oversight House Price Index, adjusted by the Consumer Price Index for all items except shelter. According to this definition, 22 out of the top 35 metro areas experienced a housing bust over the past three decades.

Data: Office of Federal Housing Enterprise Oversight, Bureau of Labor Statistics

Value For **The Long Run?** Depends Where You Buy

SAN FRANCISCO

It has its ups and downs but attracts ch buyers from around ne world. Buildable lots re scarce, so newcomers eep bidding prices up. As lobalization continues, here's no reason that pward trend has to end.

MIAMI

Like San Francisco, the city appeals to an international clientele. But unlike San Francisco and other coastal areas, it's easy to produce more housing to meet demand. That will keep a lid on prices.

PHOENIX

The recent price spike is uncharacteristic and probably unsustainable. There's plenty of empty land in Arizona, so house prices shouldn't go much above the cost of construction.

HOUSTON

The city has a healthy business climate and is the hub of the U.S. energy industry, so economic growth should continue. On the other hand, it's still easy to build, so houses could stay cheap for years to come.

BOSTON

Restrictive zoning pumps up prices, so employers have to pay more to attract and retain workers. Over the long term, companies tend to leave high-cost areas if they can. That could keep the market in check.

ep prices up, because it's easy to build: tness the current glut of Miami condos. What makes the housing supply inflexi- in markets like Boston isn't necessarily ack of land. Far more often, the cause is gulatory constraints like minimum lot es. "There's a pretty strong correlation tween volatility [of housing prices] and gulatory constraint," says Stephen alpezzi, a housing economist at the Uni- rsity of Wisconsin School of Business. aeser says that because of zoning regu- ions, the density of housing in many etro Boston communities is actually ver than in growing areas of the suppos- ly wide-open Southwest. "In Wellesley lass.], they should be building apart- ment buildings around the train stations, but it's all single-family housing," says Richard K. Green, a finance professor at George Washington University.

At this stage in the slump, restricting the supply of housing may sound like a good thing. It's not. Sure, it can make current owners richer by increasing the scarcity value of their homes. But it's murder on first-time buyers. And in the long run, it's bad for the local economy. As Glaeser notes, companies tend to migrate away from areas with costly housing to avoid paying the higher salaries needed to compensate employees for their home costs. He notes that between 2003 and 2005, high-cost Massachusetts lost 0.3% of its population, more than any other state. "The economy cannot grow unless the population grows, and the population cannot grow without new housing," he wrote in a May paper.

Thinking long term is hard when you see for-sale signs springing up everywhere. But there are plenty of places where sitting tight may be the best thing to do. ■

BusinessWeek online For a slide show of price fluctuations in 12 major metro areas, go to www.businessweek.com/extras

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ough erections lasting for more than four hours may occur y with all ED treatments in this drug class, to avoid long-term ies, it is important to seek immediate medical help.

re instances, men taking PDE5 inhibitors (oral erectile unction medicines, including VIAGRA) reported a sudden ease or loss of vision. It is not possible to determine ther these events are related directly to these medicines other factors. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

Please see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

VIAGRA is covered on the majority of National Health Plans.[1]* VIAGRA is one of several ED treatments that you and your doctor can consider.

*HMOs and PPOs; Some plans may require a prior authorization.
[1]MediMedia Information Technologies, Formulary Compass™ August 2006.

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PATIENT SUMMARY OF INFORMATION ABOUT VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- Nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- Isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- Have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- Have ever had a stroke
- Have low or high blood pressure
- Have ever had severe vision loss
- Have a rare inherited eye disease called retinitis pigmentosa
- Have ever had any kidney problems
- Have ever had any liver problems
- Have ever had any blood problems, including sickle cell anemia or leukemia
- Are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- Have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- Have stomach ulcers or any types of bleeding problems
- Are taking any other medicines

• VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking medicines called alpha-blockers for the treatment of high blood pressure or prostate problems, your blood pressure could suddenly drop. You could get dizzy or faint.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

Your doctor may prescribe a lower dose of VIAGRA in certain circumstances. For example:

- If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA.
- If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.
- If you have prostate problems or high blood pressure for which you take medicines called alpha-blockers, your doctor may start you on a lower dose of VIAGRA.

• How To Take VIAGRA

Take VIAGRA about 1 hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose

In case of accidental overdose, call your doctor right away.

• Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

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Harley Just Keeps On Cruisin'

;ing customers? ; re. Nostalgia ; and? Definitely. ; why is its stock a record high?

JOSEPH WEBER

FOR YEARS, DOOMSAYERS have been predicting that a demographic time bomb would blow up Harley-Davidson Inc. The median age of a Harley buyer has leapt from 35 in 1987 to nearly 47 ay. Whatever youthful countercultural stique Harley may have once enjoyed, ; now a middle-aged nostalgia brand. While the clock is still ticking, the ex- sion has yet to come—thanks in large t to fanatical riders like Jose Escalante. e 45-year-old roofing and landscaping npany owner from El Paso has bought ozen Harleys over the years and still ns four of them. He picked up a 2006 eamin' Eagle Ultra Clas- just last April, but was so ched about the powerful v engine and transmis- n the bikemaker added its line this past summer t he shelled out $36,000 September for the 2007 del of the big touring hog. "When I on the bike, all of a sudden I'm think- ; about the road and nothing else," s Escalante. "It shifts you from one to another."

Such devotion goes far to explain y Harley can turn comparatively small product improvements—more modest than take place in, say, the car industry—into sustained growth. As soon as the new, bigger Twin Cam engine and six-speed transmission were announced in July, orders started pouring into dealers, many from longtime fans like Escalante who just had to have the newest bikes. Over the last two years, customers have warmed to 10 new models, out of 38 Harley models in all, and to regular tweaks all across the line. Third-quarter results, announced Oct. 12, roared past analysts' estimates, with net income climbing 18%, to $312.7 million, on a 14.3% year-over-year rise in sales, to $1.64 billion. Annual sales could top $6 billion next year, says William Blair & Co. analyst Robert Simonson.

It's a vindication for Chief Executive James L. Ziemer. He inherited the reins from Jeffrey L. Bleustein, a legend who built the modern Harley-Davidson over 30 years and remains the chairman. But in Ziemer's first quarter in the corner office, Harley announced production cuts. The stock plunged 21%, to 45, and critics immediately said the demographics had finally caught up to the company. Just 18 months later, the stock (retickered HOG in August of this year) hit an all-time high of 70.

Harley is also riding high with foreign fans, who see its image as all-American in the best possible sense, meaning powerful and free. Fast-growing overseas markets like China and Japan account for more than $1 billion a year in sales, or 22.5% of all bikes sold—up from 20% last year. Retail sales of Harley bikes outside the U.S. have climbed some 16% since the beginning of the year. Even in Japan, home of Honda Motor Co., Suzuki Motor Corp., and other big rivals, Harley owns the No.1 spot for heavyweight bikes, claiming 26% of the market. Additionally, Harley sells more of its performance-oriented V-Rods and Buell models abroad than at home, especially in Europe. Simonson, the William Blair analyst, says rising foreign sales "could become an offset" if domestic growth slows.

LOYALTY IN SPADES

THAT'S ONE REASON why Harley executives see no reason to battle the youth-conscious imports head-to-head. The type of customer who chases the latest race-winning, forward-pitched sport bike is hardly brand-loyal, says Ziemer. He says 15% of Harley buyers now are under 35 and the median buyer age dropped about two and a half months last year, to 46.7. The proof of

Harley's appeal: Half the company's sales are to new customers, while the other half go to committed Harley riders whose loyalty won't fade. "You're not going to change the bike you ride when you've got its name tattooed on your shoulder," says Ziemer.

Still, the skeptics are out there. The negative view is on Harley's future, not its past or present. And the outfit has done little to shake its image with twentysomethings as Granddad's bike. "They haven't kept up with the younger riders," says Piper Jaffray Cos. analyst Anthony Gikas, a 44-year-old who owns two Harleys himself. Riders in their 20s, he adds, crave fast sport bikes—Ducatis and Kawasakis—and disdain the Harley brand.

Motorcycle experts debate over whether Harley should stick to its mainstays—the big loud machines that make for smooth rides on long stretches—or bring out sporty, less pricey Harleys for the younger, hipper crowd. Harley has experimented with lower-priced sport bikes in its Buell line, but they're nowhere near as stylish and popular as Japanese and European rivals. Suzuki this year will sell some 67,500 sport bikes in the U.S.—including about 27,000 with engines in the same class as Buell's—but Harley will sell fewer than 5,600 Buells domestically, including 4,190 sport bi says industry analyst Don J. Brow DJB Associates.

While the Japanese bikemakers qu ly make changes to suit customers' s ing tastes, the 103-year-old Harle much more conservative. Of course, easy to understand Harley's reluct to mess with its iconic image. Obse Kent Grayson, an associate professc marketing at Northwestern Univers Kellogg School of Management: ' more than a brand. It's a culture."

BusinessWeek online For a slide show of H motorcycles through the years and more ad from fans, go to www.businessweek.com/e

How Bikers Would Chart Harley's Course

Harley-Davidson has thrived by selling pricey hogs to baby boomers. But younger customers often see Harley's big touring bikes as old people's wheels, and they haven't responded much to the company's line of Buell sport bikes. Now, as its boomer customer base ages, Harley faces a strategic question: Does it change its iconic product line to win over young buyers? Here are some edited comments from a few biking fans:

JAY LENO, *owner of 80 motorcycles, including a Buell and a Harley Ultra.*

» When you look at a 1936 Harley, the family resemblance to the modern Harley holds up. If you say to someone who doesn't know anything about motorcycles, 'Pick one that looks most like a motorcycle,' they will go to a Harley. Big Harleys will always be seen as older guys' bikes, in the same way the 7 Series BMW and Cadillac are seen as older guys' cars: big, fast, and comfortable. That's what the big Harley has going for it.

LENO Hog wild

JIM ROGERS, *co-founder of the Quantum Fund and author of* Investment Biker: Around the World with Jim Rogers.

» I have never owned a Harley. They are not very well-made motorcycles. If young people are not buying Harleys, [the bikes] have got to change. Young people are not going to suddenly buy them when they turn 47. They didn't grow up with those Harley-friendly images in their heads.

GENEVIEVE SCHMITT, *founding editor of WomenRidersNow.com, an e-zine.*

» They made a huge change by introducing a more powerful engine, and that will bring in a whole bunch of new buyers who want more power and want fuel injection, which is the wave of the future. What I would do is just keep moving along with what they're doing, continuing to focus on what they do best. They've responded to the needs of smaller, less muscular riders by offering motorcycles with lower motors. They realize women are an up-and-coming segment and that they need to accommodate them. They don't market to a specific gender, but are gender-neutral. They market a lifestyle, with daughters and moms, dads and sons.

SCHMITT: Harley should maintain its focus

JOE MAMMOLITO, *tow truck company owner from Dix Hills, N.Y., and Harley devotee for 30 years.*

» I have about 14 guys driving trucks for me. The younger guys ride sports bikes, the older fellows like a big bike. I think they should get guys in their 20s and 30s accustomed to riding Harleys. They need to get the younger guys accustomed to the name, the products, and the dealership network.

COOK NEILSON, *for top motorcycle racer*

» The marketing is s powerful that the bik don't really matter. T company has a deat grip on who it is they and they know that f them to stray off in s direction would be s and suicidal, and the not going to do it.

JAMES S. LATTIMO *retired CPA and own of 22 bikes, includin Buell.*

» Harleys as preser configured are for parades. They're beautiful, the moto look good, and they sound good. But they don't handle well. They're heavy, t don't have good suspensior their engine power is [weak They've got to start making better product that appeals to today's motorcyclist, but they've got to produce it at a competitive price.

MARK BARNETT, *El Paso Harley dealer.*

» When they get into their 3 and 40s, people slow down get tired of sport bikes. If yo at the sport bike demograp the number of people on the over 40 is pretty low. As long as people don't quit riding motorcycles altogether, they going to be our customer w they turn 40.

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To See Where Tech Is Headed, Watch TI

Intel is the Big Kahuna now, but Texas Instruments is all over the digital future

BY CLIFF EDWARDS

INTEL IS THE PREMIER CHIPmaker, but there's a better bellwether for the tech industry's fortunes: Texas Instruments. Although the Dallas-based company stopped making PCs long ago, its chips are fast becoming the workhorse for key industries in the Digital Age. While Intel fights to stay inside computers, TI has made enviable inroads into markets such as consumer electronics, cell phones, and medical devices—taken together, industries that are worth more in terms of dollars and influence than PCs. "If you had to choose a single proxy for the health of the entire tech industry, TI would be the best," says Roger L. Kay, president of tech consultant Endpoint Technologies Associates Inc.

TI may not have the brand recognition of a company like Intel Corp., but chances are consumers own at least something that contains one of its products. The company raked in $2.3 billion in profits last year, much of it from supplying radio modems and applications processors to cell-phone makers such as Nokia Corp. and Samsung Electronics. Its digital light-processing chips help bring focus to high-definition televisions and projectors made by Sharp, Seiko Epson, and Mitsubishi. Then, too, there's TI's strong position in Voice over Internet Protocol (VoIP) phones, handheld video players, wireless speakers, and wireless video game peripherals.

On the strength of that massive portfolio, Texas Instruments Inc. roared back into profitability after a couple of lean post-bubble years. Among semiconductor companies last year, TI's $10.8 billion in sales ranked behind Intel and Samsung. But 25% profit growth helped propel it to the No. 22 spot on the *BusinessWeek* 50 list of the top corporate performers. "We've moved out of this PC era and into an area where communications and entertainment are driving technology," says CEO Richard K. Templeton.

TI's move into health care is evidence of its ability to find new applications for existing chips. The company's portfolio of low-power chips, wireless technology, and cellular expertise is finding a welcome home with doctors, scient device makers, and hospitals lookin use the technology to remotely mor chronic-care patients and diagnose ness. TI estimates that it logged n than $100 million in medical-equipn sales in fiscal 2005. That's a pittance day, but the market for chips in mec devices is expected to grow to $4.93 lion by 2015, according to IMS Resea

Some TI chips are finding unu uses. One low-power processor origir designed to read meters electroni for a German utility found a hom biotech company IntraPace Inc. in M Park, Calif. IntraPace decided to use TI chip in a pill to treat chronic obe Once patients swallow the pill, whi set for clinical trials next year, the sends out electrical impulses that n them feel satiated. "TI has such a bre of technologies that for a medical-de guy like me, it's like being a kid candy store," says IntraPace Chair Mir A. Imran.

THE BUSINESSWEEK FIFTY 50 The Best Performers

Of course, TI faces form ble rivals in all of its marke already has fended off Int high-def TVs and cell pho But companies such as Systems, Philips Electro and Intel are trying to b into health care as well. And TI's $2 lion research-and-development bu sprawls across thousands of prod compared, for instance, with Intel's row focus on PC and server chips.

CEO Templeton argues that TI's d sity helps balance the company's gro "With multiple customers in mu markets, we have the advantage, bec if one space isn't growing fast, the is," he says. If that remains true, sales may one day be on par with its wether status. ■

TI Chips Are Ranging **Far and Wide**

Texas Instruments PCs went the way of the dodo decades ago, but the company's chips are crucial components of key products in the Digital Age:

CELL PHONES
In addition to being in a wide range of Nokia and Samsung phones, TI chips power Motorola's W220, an entry-level clamshell phone that could help add 1 billion new customers in developing countries

CONSUMER ELECTRONICS
Projectors and televisions use TI's digital light-processing chips to offer high-definition pictures, while hot companies like Slingbox and Archos use TI's processors to enable consumers to watch video on the go

MEDICAL DEVICES
Blood-glucose monit and medical-imaging devices are just the beginning. On the horizon: Pills with TI chips that send out electrical impulses and wireless TI chips that beam info to your doctor

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50%
willingness
to change
50%
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IN THE LOOP Stewart says company CEO Lyne (left) let's her know "almost everything that's going on"

The Reinvention of Martha Stewart

The domestic guru is once again the face of her brand, but she's no longer calling all the shots

BY DIANE BRADY

MARTHA STEWART IS deeply immersed in what she calls "this era of me." Since completing her 10-month sentence in August, 2005, for lying to government officials about a stock sale, the lifestyle guru has spent most of her waking moments trying to bring the world back to Martha. She has helped design new homes, forged a slew of merchandise deals, completed a 750-page book, and launched her 24-hour radio channel. She hosts a daily live TV show. She's helping to create a search engine of Martha-approved sites, and even is developing a line of food.

Stewart feels vindicated—and tired. "I don't go out as much at night as I used to," she says, noting that she can't get her mind off work long enough enjoy a Broadway show. "Ar don't have enough time to tr el. I just don't. There's too m to do." To all the naysayers w said her 15 minutes were fin up, the implicit message is: T that. Securities regulators r have stripped her of the ch man and CEO title and der her a seat on her own boar something that pains her to day—but Stewart is dream big again.

NO BABYSITTING

SOMETHING fundamental changed, though: Stewart longer has total control over brand she built. She still o the bulk of the company's s and holds 92% of the vo power—prompting specula that she may one day tak private—but she can't dic the agenda. She has a str and media-savvy CEO in St Lyne, whom Stewart says "i tremely fair in letting me k almost everything that's g on." Stewart also answers t independent board, led by c chomping entertainment vet Charles A. Koppelman—a man so Martha-like that he refers to flowe "some pink things" and thought not of putting up in his office a massive p of his grandchildren, visible from otherwise austere halls of headquar Moreover, what was once an army of r Marthas with careers largely tied to famous boss has morphed into a r eclectic and professional manager team. Sally Preston of Rodale has c in as senior vice-president of publisl Yahoo! veteran Holly Brown manage Internet business; and former Kate S president Robin Marino has taken merchandising. As Lyne puts it: "W got people running segments who ca a lot of their work and planning inde dently. They don't need to be babys any shape or form."

Is Martha Stewart Living Omnin Inc. now at the point where it ma need Martha Stewart to survive?

Lyne, who became CEO in late 2 certainly thinks so, noting that "we

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Martha's Worl

PUBLISHING

- *Martha Stewart Living* magazine is bringing in 54% more ad pages this year, but is still off the pre-ImClone glory days.
- *Blueprint*, Martha's mag for the hip crowd, just put out its second issue, with about 70% of advertisers back.

- *Everyday Food*, the faceless but friendly recipe digest, is almost breaking even, with ad pages up 42% this year.
- *body+soul* is all about whole food and inner peace, and its circulation has grown by 45% in the past year.
- *Martha Stewart's Homekeeping Handbook* hits stores this month, and a new book publishing program will launch next year.

TV/RADIO

- Martha's 24-hour radio channel will air on Sirius for at least three more years, bringing in $7.5 million in annual royalties. Daughter Alexis proves to be a funny host.
- *The Martha Stewart Show*, a daily live TV show, is a terrific marketing platform for the brand. But it loses money, and rivals like Rachael Ray loom large.
- *Everyday Food*, the TV show, runs weekly on PBS and makes a profit.

ON THE SET WITH MR. T

INTERNET

- Radically reorganize the site, including the integration of video content.
- Rolling out a new search engine to scan its own site and about 1,000 favorites chosen by Martha and team—complete with commentary.
- Partnership with Kodak to create a broad line of digital photo products. First up: holiday cards and photo books this fall.
- Content partnership in the works with Yahoo.

HOLIDAY CARDS

MERCHANDISING AND LICENSING

- A line of more than 1,400 Martha-branded plates, linens, and other home goods will roll out in Macy's in 2007.
- Launch of 350-color paint line in Lowe's early next year, as well as Martha Stewart Crafts through EK Success as well as flooring and lighting.
- Kmart partnership runs through the end of 2009, though guaranteed minimum payments will fall from $60 million to $20 million.
- Extensive deal with KB Home to build Martha Stewart home throughout the U.S. By spring of 2007, homeowners can choose from a Martha-approved selection of floor coverings, doors, and fixtures, among other things.

HOMES BY MARTH

a depth and breadth that wasn't there a year ago." While the former ABC Entertainment president and *Premiere* magazine founder isn't about to back away from the woman who defines the brand, she treads carefully: "We are embracing it, but trying not to overuse Martha, the personality." Even perennial pessimists such as Dennis B. McAlpine of McAlpine Associates says he's "very impressed with Susan's ability to get things done. There's a move to make Martha Stewart more like Betty Crocker, more ephemeral."

LOOMING PRESENCE

STEWART, NATURALLY, prefers not to talk about what the company would be like without her. At first, she will only express the hope that her name will have the longevity of Coco Chanel's or Walt Disney's. When pressed, she does say that "if I played a lesser role, the company could still do extremely well."

At 65, though, she considers that prospect to be far off. She has no intention of pulling back her looming presence over the brand. She saw the damage that downplaying the Martha Stewart name caused for her company during "the legal problems," and she won't let that happen again. "I never agreed with that strategy because I believed in myself," says Stewart. The goal now is to take her brand as far as it will go and return her company to profitability (it hasn't made money since 2002 and in 2005 lost $76 million). "It's not like I'm an absentee founder, holed up in my château in France," she laughs. "I'm working every day."

And sometimes it really can feel like hard work. In some ways, Stewart acts more like the talent than the top boss, stoically doing what's needed to pu the brand. Take her daily live televi show. "It's, um, challenging," ad Stewart, who prefers the leisurely and "wonderful flow" of an edited sl "A live show really curtails your ity to get in as much serious conter the other show. You also can't put i many field trips and experts as you to have. You have three minutes t everything." Working in front of an a ence is nice, she adds, "but it feels a rushed sometimes."

As strong as Stewart's comeback been, she faces intense competition f new personalities. Rachael Ray, for hosts a show that now averages million viewers, 46% more than S art's, according to Nielsen Media search Inc. Starcom USA President C Boothe argues that Stewart is "p

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much holding her own at a difficult time of day," while Ray benefits from being positioned between *Live with Regis and Kelly* and *The View* in some key markets. But Ray is getting a lot of buzz. Stewart insists she isn't concerned: "Her daily show is much less appealing than her Food Network show. It's very disjointed and loud, and I don't learn anything."

MAKING UP FOR LOST TIME

STEWART ALSO ADMITS to mixed feelings about her partnership with Kmart Corp., which she fashioned more than a decade ago. It made her a force in merchandising. But since merging with Sears Holdings two years ago, the retailer is still, as she puts it, "struggling to get all the stores in the shape that they ought to be." Her company gets minimum guaranteed payments of $60 million annually—about double what it would otherwise earn from current sales—but those guarantees shrink to $20 million in a few years. "It's a monstrous consolidation of two monstrous retailers, and the jury is still out," she says.

The deals that are really propelling the company these days owe as much to Lyne's deputies as Stewart herself. Merchandising chief Marino was key in working out an agreement with Macy's to develop a line of Martha Stewart products that will launch next year. As Janet E. Grove, CEO of Macy's Merchandising Group, says: "Robin and I have known each other for a long time. She really understands how customers shop and why they shop." Stewart is important, but Grove believes the Martha Stewart aura transcends the person. "The brand will prosper in any situation," she says.

Deals with Macy's and KB Home take Martha's brand beyond Kmart

Koppelman, ever the dealmaker, forged what looked like a kooky scheme with KB Home to build Martha Stewart-designed houses in the $400,000 range around the country. While some might question launching "themed" communities amid a housing downturn, "they're incredibly well-built and selling like hotcakes," says analyst Robert Routh of Jefferies & Co. Stewart's team helped design the prototypes, asking architects to put in Martha touches like mud rooms and cabinets that stretch to the ceiling (fewer dust bunnies!). The company gets royalties and, soon, a chance to buyers exclusive Mar products. KB Home C Bruce Karatz notes t buyers have snapped the initial 300 home two communities.

Amid it all sta Stewart, eager to m up for lost time.

She has develope strong interest in the "prolongatio life"—recently giving a $5 million dc tion to New York's Mt. Sinai Hospita set up the Martha Stewart Center for ing, which will promote healthy ag She thinks it's a concept that could national. Despite the apparent frenz her life, Stewart goes on early morr hikes, practices yoga, and has sta horseback riding. She is building ba from scratch. She has a "man frie former Microsoft Corp. executive Cha Simonyi. She has "no comment on p Peter" Bacanovic, the former broker was involved in the ImClone stock s dal and served time in jail. Stewart moved on. "In the creative area, I'm very involved," she says. "I don't l time to be CEO." ■

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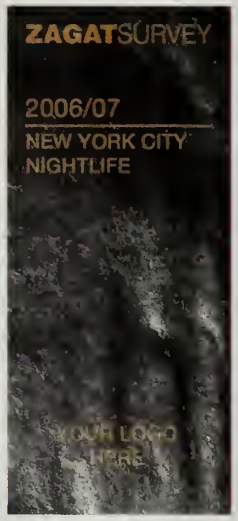

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2006 Business Travel Update

FREQUENCY PROGRAMS have become so ubiquitous that an entire cottage industry has sprung up to help road warriors make the most of their points. There are Websites on the topic (FrequentFlier.com, webflyer.com), portals (points.com), newsletters (First Class Flyer), and blogs galore. The guru of frequency points, Randy Petersen, has also recently published an excellent trade paperback *(The Official Frequent Flyer Guidebook: The Essential Frequent Traveler Program Guide)* on the subject.

The good news about travel-reward programs is that competition is so fierce that suppliers are constantly making enhancements. Rewards are more flexible than ever. Besides being able to earn free or discounted travel, you can now use points for a wide array of merchandise as well as upgrades and free tickets, hotel rooms and rental car days. Redemption is much easier, too, than the snail-mail systems of old; Web-based versions allow for fast and easy points transfer and reward selection. On Etihad Airways, for example, you can even redeem your points instantly in its brand-new Guest program (for details: www. etihadairways.com).

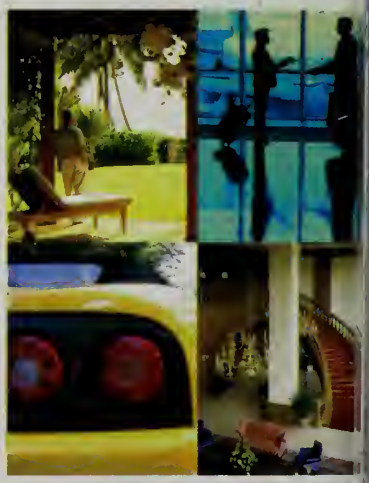
Several low-cost carriers are getting into the game, too, adding a frill to lure business travelers to their mostly leisure-based ranks. European low-cost carriers Germanwings and Virgin Express, Australia-based Virgin Blue Airlines, Asia-based Kingfisher, Hawaii-based Go and Spirit Airlines all have rolled out loyalty programs in the past year, reports *Business Travel News*.

As for hotel rewards: these are also being enhanced regularly. **TripRewards** members, for example, now can exchange points and miles between multiple loyalty programs. Thanks to an agreement with Points.com, the rewards management portal.

TripRewards is actually the world's largest loyalty program, based on the number of participating hotels (more than 6,00 properties, from budget to high-end). According to Jill Noblett vice president of direct and loyalty marketing, it's also the first travel-related loyalty program geared more toward leisur travelers than road warriors, who often amass hundreds of thousands of points in their accounts from business trips. "We found that the leisure traveler is a demographic that's been largely overlooked," she said.

The program's "open earn" structure allows members fast access to point earning by staying in one of Wyndham Worldwide's nine lodging chains, including the Wyndham®, Ramada® Super 8®, Wingate Inn® and Days Inn® brands; its vacation exchange and rental businesses including RCI®, Novasol® and Landal GreenParks®, and its timeshare resorts business includin Fairfield® Resorts and Trendwest® Resorts; by renting Avis® anc Budget® rental cars, and by purchasing everyday products anc services from program partners.

Likewise, TripRewards members can redeem their points for either hotel stays – with no blackout dates – or partner rewards, including airline tickets, resort vacations, electronics, home appliances, sporting goods, movie and theme park tickets, and gift certificates from popular retailers and restaurants. The program's online point redemption store, TripRewards Marketplace, is frequently enhanced with products that really resonate with consumers — such as iPod® digital music players, Godiva® chocolates and gift certificates to popular restaurants and stores throughout the country.



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DEFENSE EDGE Uncle Sam is shelling out $125 billion

More Elbow Room on the Net

A pending upgrade will provide an almost limitless number of address

BY DAWN KOPECKI

THE INTERNET MAY SEEM infinite, but it is running out of space. Fortunately, computer scientists have figured out a fix, and they could get a big boost from the federal government.

The problem—all the possible Net addresses will be used up in five years—can be solved by upgrading the decades-old standards that govern how different devices communicate with each other. The upgrade, called Internet Protocol version 6, was developed a decade ago and mostly has been sitting on the shelf—until now, that is. Anxious about how China and Asia are starting to upgrade their computer systems to take advantage of IPv6 capabilities, the Defense Dept. and the White House are trying to jump-start IPv6 use in the U.S. through billions of dollars in technology improvements. "This is going to be big," says former IRS Commissioner Charles Rossotti, a senior adviser to private-equity firm The Carlyle Group, which recently placed a $15 million bet on a startup working on the government's IPv6 transition. "Some significant sectors of the economy, notably the Defense Dept., are starting to move quickly."

Or at least as quickly as a bureaucratic behemoth can move. Even simple shifts in organizations as complex as the Defense Dept. are difficult. Although the government plans to spend tens of billions over the next 10 years to upgrade its computer and phone systems, it faces competition for that funding from the Iraq war. "Some of the operational folks are having to make some tough decisions, like supporting today's war fighter by buying a tank...or supporting the transition to IPv6," said one senior Defense official who asked not to be identified.

Still, there is urgency for moving toward the IPv6 model. Unless technologically advanced nations migrate to the new standard within four or five years, the world will exhaust its supply of IP dresses, which are assigned to all c puters and other devices that excha data over the Net. But once the hardv and software upgrades to IPv6 are c plete, they will open up so much terri in cyberspace that a unique address be assigned to every digital product i world—and every one produced fo next several centuries. In theory, means that everything from adva weapon systems to home appliances be able to configure its own Internet nections, update its software, and r attacks from hackers.

FOOT-DRAGGING?

COMPANIES AND countries that r this transition quickly could reap economic and military advantages. the U.S., companies that produce net equipment have barely started to pro IPv6 products because there's litt mand in the general market. And such as Internet service providers a

recommends Windows® XP Professional

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The Net On Steroids

berspace is running out of Internet dresses. But by upgrading one key ndard, called IPv4, techies can vide a lot more space. The new sion, IPv6, has more than enough pacity to give every electronic device earth its own address, and then me. Here's a quick comparison:

ADDRESSING

4 Accommodates 4.3 billion IP dresses, which will be used up around 2010

6 Handles 340 undecillion addresses. That's 3.4×10^{38}

CONFIGURATION

4 Setting up equipment under the rent standard can be a cumbersome nual process

6 Devices automatically detect a twork and configure their settings to it

SECURITY

4 Extra equipment and programs needed to encrypt data and thenticate users

6 Encryption, authentication, and her security measures are built into new standard

noring for change, mainly because the rade to IPv6 will require them to nd mountains of cash to tweak every e of hardware and software and re- n their technical staff.

That's where the buying power of the . government comes in. Federal pur- sing officials have already said they n to require all civilian and defense ncies to upgrade their key network ipment—routers, computer servers, tches, and such—to IPv6 within 20 nths. By next spring, the General Ser- es Administration (GSA) plans to ard two of the largest government tracts ever, totaling $125 billion, to rhaul the government's phone sys- s and IT infrastructure. The GSA also ignates a record-breaking $25 billion contracts for small or minority busi- ses. "These are big numbers even en you look across the federal govern- nt," says James A. Williams, who runs A's Federal Acquisition Service.

The military likes the new protocol for many reasons. Under IPv6, members of a battalion deployed overseas will be on-line in a matter of hours, not weeks. Also, every electronic device can tap into the Internet directly, without having to go through a server. A soldier's gear, for example, could be fitted with sensors that transmit data to commanders. "We'll be able to see what a soldier sees through the scope of his rifle. We'll be able to check his vitals," says Kris Strance, a senior IT analyst at Defense.

CHINA CALLING

THE U.S. MILITARY feels pressure to move quickly on IPv6 primarily because of the advances by the Chinese government. China may be one of America's most important trading partners, but it also poses competitive threats. U.S. military officials who asked not to be named say the majority of hacker attempts on the Defense Dept.'s Global Information Grid originate in China. Defense officials say the U.S. can't afford to fall further behind. "We're going to give a technological advantage to countries that aren't quite friendly to us and that are developing nuclear capabilities," says another Defense official who asked not to be named.

Military concerns are driving IPv6 adoption in the U.S. today, but government officials hope the wave of federal purchases kick-starts production of IPv6-compatible technology for the general public. Some of the first IPv6 windfalls will go to ventures that help government agencies through the transition, such as Command Information in Herndon, Va. The beneficiary of Carlyle's $15 million investment, the company landed a piece of a $4 billion Army IT contract. It expects to generate $50 million in revenue this year and plans to hire dozens of new employee by the end of December.

Down the road, IT hardware and services giants such as Cisco Systems, Hewlett-Packard, and Verizon could reap the biggest rewards. HP, which does $2 billion in federal work each year, is stepping up production of IPv6-compatible printers and servers, and hopes to upgrade its entire product line over the next two years. "Without government requirements, I'm not sure there would be the will to make [that] happen," says Steve Henderson of HP's federal contracting division. Cisco's full product line is now IPv6 compatible, says Gerald T. Charles Jr., a director in the company's Internet Business Solutions Group. "You're going to get to a point where you need to be IPv6-capable, or you're going to be left behind." ■

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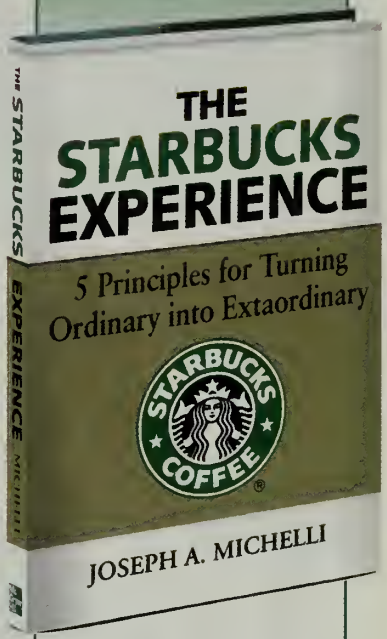

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ON WISCONSIN A new biotech program addresses industry needs

Biotech's Beef

Companies say grad schools aren't stressing what students require in the real world

BY NICHOLA SAMINATHER

THE U.S. IS THE MECCA OF biotech. Most top companies in the field are based here. Government research budgets in biology are immense and growing. Universities compete to attract great professors. Students flock to their courses. And once they're armed with graduate degrees, they can count on landing a job in the industry.

Or can they? In recent months biotech outfits have begun to complain that job applicants coming out of U.S. universities lack the knowhow companies seek. Left unresolved, the troubles could stifle growth in this booming sector, valued at $48 billion last year by consultant Ernst & Young. The knowledge deficiencies could also force biotech companies to move more of their operations overseas, say executives and recruiters.

The problem is a disconnect between what universities are teaching and what biotech wants. "The focus of academia is getting basic and theoretical knowledge in place," says E. Dale Sevier, a director at the California State University Program for Education & Research in Biotechnology. "The skills needed to be successful in the industry are just not taught in universities."

There are several weaknesses. First, recent grads lack the technical knowledge to carry out applied research in areas that straddle engineering, math, and computers. Second, job candidates have little awareness of what the Food & Drug Administration is looking for when it considers whether or not to approve a drug. Recent grads simply aren't familiar with issues such as quality control and regulatory affairs. Academic programs "don't train students to function in today's small-R, large-D environment," says Stephen Dahms, president and CEO of the Alfred E. Mann Foundation for Biomedical Engineering.

The California State University biotech program tried to identify what companies want from new hires in a 2000 report. Close to the top of the list are familiarity with FDA compliance, experience in clinical trial design, and quality control. All require knowledge of computing, statistics, and database management—pretty low priorities for most academic biotech programs.

As it happens, these are common credentials for foreign researchers in the U.S. who hold temporary work papers known as H-1B visas. U.S. Citizenship & Immigration Services reports that 3.6 of all H-1B visas for 2003, a total of 7,1 went to employees in scientific resea and development. Some 80% of th have graduate degrees from U.S. univ sities, Dahms says, but "there's son thing special about the prior expos of foreign nationals. They have a m applied R&D perspective." Of cour there are smart U.S.-born candida with good math and computer ski But they're rarely f ent in both math a life sciences.

Invitrogen Cor a biotech company Carlsbad, Calif., c rently employs about H-1B visa holders in a workforce of 5,0 and it needs more. The company hi 1,000 people last year and will raise t to 1,400 this year. But with H-1B quo filling up earlier every year, Invitrogen chosen to do more drug development Japan, China, and India. It may also o facilities in Korea and Singapore, s Rodney Moses, Invitrogen's vice-pr dent of talent acquisition. Compensat in China and India is lower than in U.S., but that's not what motivates move offshore, says Moses. "If the tal is located in Singapore, it's just easier us to go there."

U.S. colleges take the problem s ously. State university systems in Cali nia, Wisconsin, and elsewhere are add more industry-oriented classes. Cali nia State has crafted a curriculum that cludes chemistry, engineering, and c puter science. A new biotech progra the University of Wisconsin's Stout c pus offers statistics and technical w ing. Students must also work full-t at a biotech comp during the summe for a semester.

Industry buys this idea. Invitro is sponsoring occu tional summer ca for high school dents, hoping to nu them into taking m science and m courses. Many o companies are set up intern and app tice programs to i tify promising stud and prepare them f post-academic career. After all, the in industry isn't just to raise interes questions, as in academia. It's to the answers. ■

The Right Stuff

Recruiters are looking for skills in the following areas:

- Regulatory affairs
- Quality control
- Clinical data management
- Clinical trial design
- Statistical analysis

Source: California State University Program for Education & Research in Biotechnology

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Nukes have powered naval ps, but now the technology ıld make its civilian debut. senergoatom, Russia's vate nuclear-energy mpany, is building a 120- gawatt plant on a barge. ıen finished in 2010, it will towed to the White Sea, in ssia's far north, to power ning operations as well as arby towns. Details about board safety systems scant, raising red flags. e U.S. developed, but andoned, plans for nuclear rges in the 1960s.

–Adam Aston

MEDICINE

STREP THROAT MEETS ITS MATCH: SNAKE VENOM

ONE OF THE WORLD'S deadliest snakes may help researchers conquer dreaded "flesh-eating" bacteria. Scientists at the Methodist Hospital in Houston have discovered an enzyme that promotes A streptococcus infections, which cause strep throat and necrotizing fasciitis, a disease that destroys soft tissue, killing half its victims. The enzyme resembles a toxin found in the venom of the Australian common brown snake.

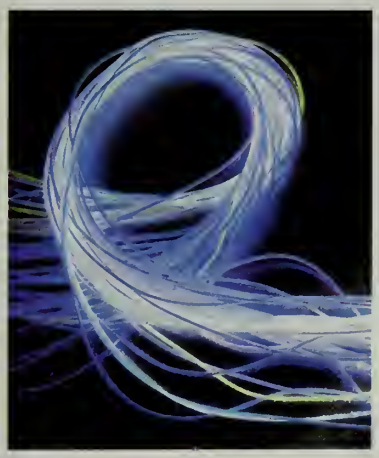
The researchers used the human form of the toxic enzyme to create a vaccine, which they tested on mice. The vaccine shielded the mice from the most invasive strep infections. The snake could help the scientists find more ways to neutralize strep. Snakes produce venom-fighting chemicals naturally, because "if you're a snake, you don't want to intoxicate yourself with your own venom," explains Dr. James Musser, executive vice-president of the Methodist Hospital Research Institute. Based on such protective molecules, scientists might develop more effective drugs.

SECURITY

WATCHING THE WATER SUPPLY

NEW WATER-SURVEILLANCE systems promise to detect bioterror attacks more quickly and accurately than is possible today. Ever since the 2001 anthrax attacks after September 11, the Homeland Security Dept. has been concerned about the possibility of biological threats to public resources, including the water supply. Researchers at Sandia National Laboratories, the University of Cincinnati, and Argonne National Laboratory paired up with the Environmental Protection Agency to develop the WaterSentinel Program: software that monitors municipal water systems in real time. It is being tested in Albuquerque. Another system developed by the U.S. Army Center for Environmental Health Research and sold by a San Diego company monitors changes in fish behavior to detect potentially toxic events.

–Aili McConnon



ENCRYPTION

TAKE THAT, HACKERS

TWO PRINCETON University scientists have developed an alternative to conventional encryption for sending secure messages over the trunk lines of the Net. Their approach exploits the background noise, or "jitters," created by torrents of data surging across optical fibers.

First, a device called an encoder stretches out the short pulses of light that make up a message to be secured. These stretched pulses are so quiet that they hide in the jitters. A decoder on the receiving end takes the elongated signals and restores them to their original form.

This technology could prove superior to ordinary encryption, which relies on software code called keys. "When you're using encryption, you still disclose that secure communication takes place," which may invite attention from hackers, explains Evgenii Narimanov. He developed the new approach with his colleague Bernard Wu. The technology could be combined with conventional encryption, they say.

There is a drawback to stretching signals: You end up sacrificing some of the speed that makes fiber-based communications so desirable. The secure transmission rate is around 760 megabits per second, vs. 10 gigabits for nonsecure transmissions.

–Nichola Saminather

Location, Location, Location

Navteq is leaving its mark on every aspect of navigation technology

BY ROGER O. CROCKETT

PARDON THE EXPRESsion, but Judson C. Green, CEO of digital mapmaker Navteq Corp., insists his company is pointed in the right direction. The Chicago tech company etched a reputation selling maps for the navigation systems in luxury models from General Motors Corp.'s Cadillac Escalade to BMW's 7 Series sedan. Now some auto industry customers are mired in a sales slump that's dragging down orders of Navteq gear. Still, Green believes the company will "really take off in the future."

That may be more than stubborn optimism. Green displayed an uncanny ability to peer into the future back in 2000, when he and his team set out to reinvent the way people interact with maps. They married satellite technology with a deep database of road information: street names, speed limits, and commercial and residential locations. That data positioned them well for a boom in car navigation systems. Navteq's performance over the past three years propelled the company to the No. 5 spot on the *BusinessWeek* Hot Growth list for 2006.

Then came the speed bumps. Interest in car-based navigation guides began to wane, in part because of $2,000 price tags. Growth in the market for such systems has slowed, even as the percentage of cars that offer them has risen, says Brett Manderfeld, an analyst at Piper Jaffray Cos. This trend showed in Navteq's second-quarter earnings, announced July 26: They were $23.8 million on sales of $136 million, well below Wall Street's expectations. Shares have sunk to around 28, down from 47 last January. On Oct. 25, the company was expected to announce third-quarter sales of $140 million. That's 13.7% more than the year before, but just half the size of previous third-quarter surges.

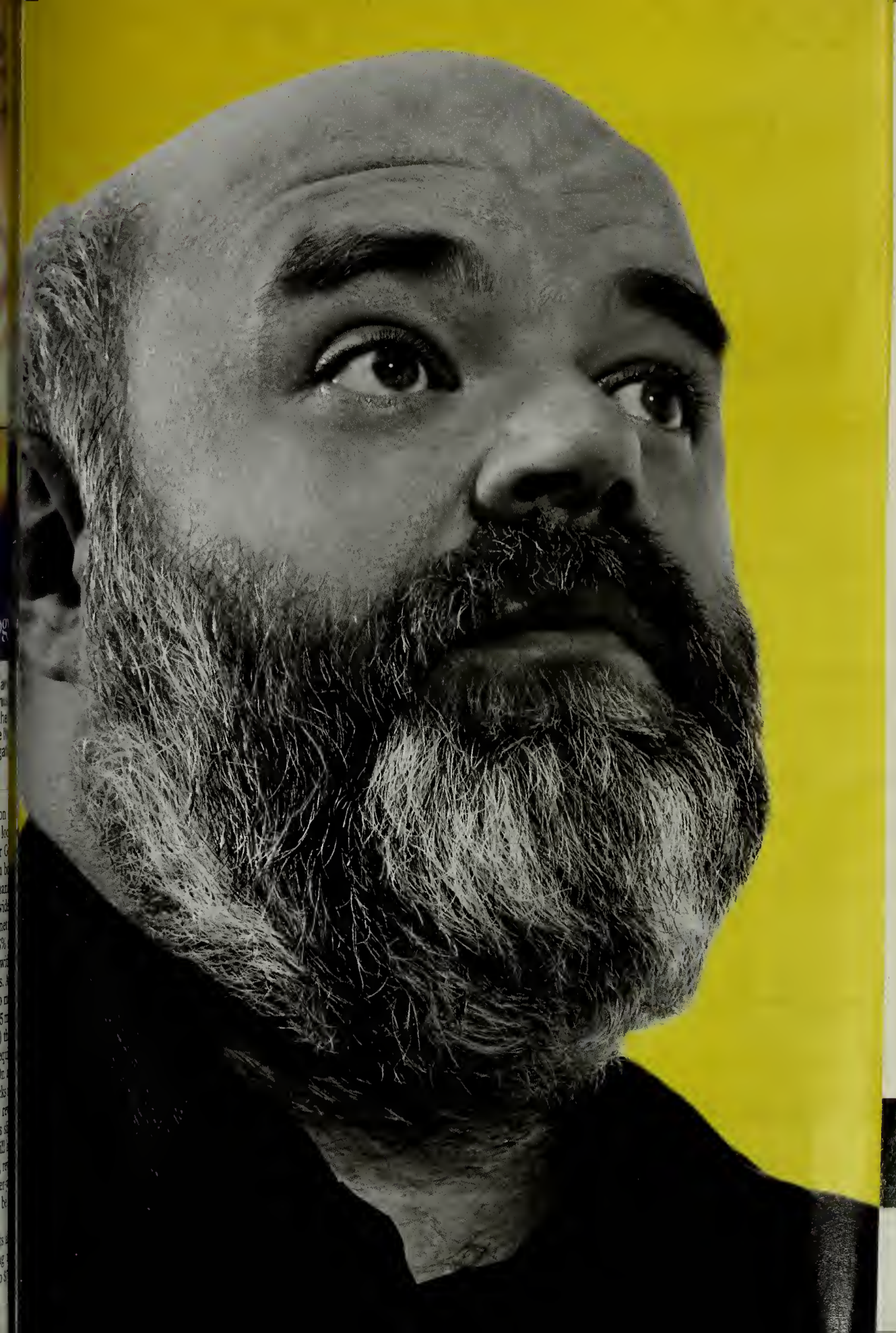
Despite the Street's harrumph, Green refuses to manage for the short term. He contends that demand for satellite technology, whether in cars or pocket devices, is bound to hit new heights. Do the math, he says. This year in Western Europe and North America, roughly 35 million cars will be sold. But the market for portable devices—from cell phones to pocket-size navigation tools—will total more than 315 million units. The turnover in this market is rapid, and in coming years, most of the new models will include location capability. Right now about 12% of vehicles have navigation systems, compared with only 1% of handheld devices. Thinking of tomorrow's households, "I'm imagining [location services] on both cars, all their cell phones, and even on their digital cameras, iPods, and games," Green says.

GREEN Cars, cell phones, iPods—the sky's the lim for navigatio systems

Navteq is leaving its mark on e form of technology suitable to loca services. Ever use MapQuest or Go to get directions? Or maybe you bo one of the nearly 15 million hand navigation devices sold worldwide year. Navteq now owns the Internet m ping market with roughly a 95% s and splits the handheld market with ropean rival Tele Atlas. A sells more map data to ma of handheld devices (1.5 mi in the second quarter) tha makers of navigation-equi vehicles (1 million). On a lar basis, cars and trucks n up 100% of Navteq's rev in 2000. This year the ratio has sli to 70%, and Green figures it will b reach 50% in 2008. Meanwhile, rev growth from handhelds year-over-y expected to double, while it will be l to hit 15% in the auto market.

That's not to say new markets al mean hot growth. When selling t auto sector, Navteq makes $60 to $7

HOT GROWTH COMPANIES



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That may be more than stubborn optimism. Green displayed an uncanny ability to peer into the future back in 2000, when he and his team set out to reinvent the way people interact with maps. They married satellite technology with a deep database of road information: street names, speed limits, and commercial and residential locations. That data positioned them well for a boom in car navigation systems. Navteq's performance over the past three years propelled the company to the No. 5 spot on the *BusinessWeek* Hot Growth list for 2006.

Then came the speed bumps. Interest in car-based navigation guides began to wane, in part because of $2,000 price tags. Growth in the market for such systems has slowed, even as the percentage of cars that offer them has risen, says Brett Manderfeld, an analyst at Piper Jaffray Cos. This trend showed in Navteq's second-quarter earnings, announced July 26: They were $23.8 million on sales of $136 million, well below Wall Street's expectations. Shares have sunk to around 28, down from 47 last January. On Oct. 25, the company was expected to announce third-quarter sales of $140 million. That's 13.7% more than the year before, but just half the size of previous third-quarter surges.

Despite the Street's harrumph, Green refuses to manage for the short term. He contends that demand for satellite technology, whether in cars or pocket devices, is bound to hit new heights. Do the math, he says. This year in Western Europe and North America, roughly 35 million cars will be sold. But the market for portable devices—from cell phones to pocket-size navigation tools—will total more than 315 million units. The turnover in this market is rapid, and in coming years, most of the new models will include location capability. Right now about 12% of vehicles have navigation systems, compared with only 1% of handheld devices. Thinking of tomorrow's households, "I'm imagining [location services] on both cars, all their cell phones, and even on their digital cameras, iPods, and games," Green says.

GREEN Cars, cell phones, iPods—the sky's the limi for navigatio systems

Navteq is leaving its mark on e form of technology suitable to loca services. Ever use MapQuest or Go to get directions? Or maybe you bo one of the nearly 15 million hand navigation devices sold worldwide year. Navteq now owns the Internet m ping market with roughly a 95% s and splits the handheld market with ropean rival Tele Atlas. A sells more map data to ma of handheld devices (1.5 mi in the second quarter) tha makers of navigation-equi vehicles (1 million). On a lar basis, cars and trucks r up 100% of Navteq's rev in 2000. This year the ratio has sli to 70%, and Green figures it will b reach 50% in 2008. Meanwhile, rev growth from handhelds year-over-y expected to double, while it will be to hit 15% in the auto market.

That's not to say new markets al mean hot growth. When selling t auto sector, Navteq makes $60 to $7

HOT GROWTH COMPANIES

Thousands of midsize companies run SAP?

batch of maps, according to Manderfeld. It gets only $20 to $30 for each mobile device, and on the Internet, it earns just a fraction of a penny per click. So Navteq has to sell many more units to match its historic revenue growth.

KILLER SERVICES

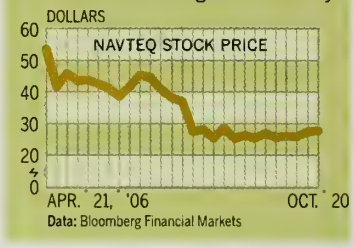
GREEN UNDERSTANDS the challenge: Navteq needs to expand the market, and it can't do that alone. So the company has begun to sponsor conferences designed to foster the development of killer location services. The events, held every year at the national cellular convention, invite developers to build innovative applications for cell phones and other gear. Participants have free access to Navteq's map data and tools, and the winners compete for more than $2 million in cash and prizes.

The events attract attention from the likes of Verizon Wireless, Sprint Nextel, Nokia, and major venture capitalists. "Navteq has done a nice job of helping to move the whole industry forward," says J. Kim Fennell, CEO of deCarta, a provider of location-related software in San Jose, Calif. "They realize that they can't make everything happen on their own."

In the future, wireless carriers will probably rank among Navteq's biggest partners. In the U.S., Verizon Wireless and Sprint Nextel have already rolled out cell-based services that allow users to pinpoint where their famil bers are at any gi ment or navigat say, Myrtle Bea to the Lincoln M in the nation's Sprint and Veri offer location technology for fit thusiasts develo a winner of the contest. Softwa Bones in Moti lets runners a clists use their phones to r their distance, pace, and ro maps. Verizon Chief Technolo cer Dick Lynch says just what likes to hear: "We see an oppo to sell location services to eve tomer we serve." ■

MAPPING A PLATEAU

Navteq sees plenty of growth, but investors are looking the other way



Data: Bloomberg Financial Markets

MOBILE NETWORKS

The Long Arm of The Cell Phone

By now, anyone with a Net connection is familiar with social networking sites such as MySpace.com. The only name that may score higher on the buzz-o-meter is Barack Obama. But the momentum has really just begun. Site operators are linking their services to cell phones, enabling users to stay in constant touch without booting up a PC. Social networking has "become so incredibly viral," says MySpace CEO Chris DeWolfe, "it makes all the sense in the world to port this to a mobile device."

Now more cell services are incorporating location-based satellite technology and maps from the likes of Navteq Corp., making all kinds of social applications possible. Services such as Dodgeball.com, Geocaching.com, and Plazes.com help satellite-linked users find restaurants, nightclubs, and movie theaters, and learn where friends in their network are congregating. All they need to do is press a few buttons to pull up the best route to a desired destination.

Consider the intimate world of Dodgeball, where tens of thousands of users in 22 major U.S. cities zap their locations to one another. Members of the Dodgeball community link up by typing in the name of a location—say, Wrigley Field or the Museum of Modern Art—and se it to Dodge (36343). This will broadca their whereabouts to others in their cr Dodgeball also automatically lets user know if a network buddy is within 10 bl so they can arrange to meet spontane "Young people really do count on that phone as a connecting device," says J. Fennell, CEO of deCarta, whose softwa helps drive some of these applications

Connections have flourished at Geocaching.com, where members immerse themselves in a digitally aide scavenger hunt. Relying on maps disp on handheld devices, people search f items—everything from toy dolls to ra coins to business cards—in container hidden in a park or other public space can keep what you find, but be sure to something in its place.)

Millions in the U.S. and overseas ha been pulled into these high-tech treas hunts. Using their handheld mapping they can track where others have bee and often they come together to share their experiences. About 700 geocach congregated earlier this year at a Texa event dubbed "GeoWoodstock IV."

There are obvious risks to privacy frontier, so caution is clearly warrante If and when MySpace enters the gam may have to impose certain rules abo how users locate one another. The ke DeWolfe says, "is to give the consume the ability to opt in or opt out" of havi his or her location revealed. Without authorization, no retailer or advertise maybe not even your friends—shoulc able to locate you.

—*Roger O. Croc*

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Project-Based RPO Good Option For Professional, Managerial Talent

A pharmaceutical company needs managers for a new manufacturing plant. An Internet service provider is expanding into new wireless markets and is looking to hire technology and business professionals. A global food processing business is investing in mid-level managers capable of assuming future leadership roles.

In each of these situations, the smartest solution in the current candidate-driven market may be to outsource the recruitment function to an external firm. Recruitment process outsourcing (RPO) is the fastest growth area in HR outsourcing. While a significant portion of the increased volume will come from long-term HR contracts, the number of companies outsourcing recruitment on a project basis also is expected to increase. In addition, companies that have traditionally outsourced recruiting for lower-level jobs are beginning to do so for managerial and professional positions.

As more companies recognize the value of entering into strategic partnerships with recruitment experts for higher-level hires, the question becomes, "What should companies be looking for in a partner?"

Certainly, the partner must be able to offer quicker access to high-quality potential more cost effectively than companies can on their own. Beyond that, however, emp should choose a partner capable of crea flexible, scalable project plan that is inte with the client's business objectives. Th should be based on best practices such as sourcing, building sustainable talent poo utilizing competency models to assess dates. The recruitment partner shoul accountability for delivering the desire come to the client as well as managing Whether a company has an immediate r hire a finite number of managers or prof als, or wants assistance over the long te RPO partner may be the solution.

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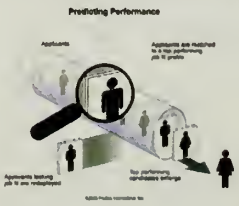
Predicting Employee Performance Increases Your Company's Value

Business leaders have long known what research has recently validated: human performance is linked with overall corporate performance. Companies must capitalize on the strategic opportunities created by building and maintaining a high-performance workforce.

When managers accurately forecast employee performance, positive business outcomes become more predictable. The ability to predict employee performance by comparing it against the organization's models of top performance allows managers to hire those who exhibit similar characteristics and as a result, more clearly forecast outcomes.

"Properly designed and validated occupational assessments help companies know what people have done in the past to create success as well as what their potential is to perform successfully in the future," said Jim Sirbasku, CEO, Profiles International. "Using this information, candidates and employees can be placed in positions where they are most likely to perform at their best."



To build a high-performance workforce:

• Formulate a clear vision of the company's current workforce situation and create a plan to pre future needs.

• Develop a plan to retain talent and employees gain the skills they need to lea future. All training programs should be alig corporate performance objectives.

• Establish an integrated approach to eac Human Resource processes: recruiting, hiring, ance management, training and succession pla

• Know employees' natural job-related chara as well as their skill sets and competencies so talents can be deployed where they are needed

Workforce performance significantly impacts results. A manager's ability to predict employee ance makes accurately forecasting the company's ance possible and ultimately impacts your botto

To read the full report, go to www.expert-insights.com/profiles.asp

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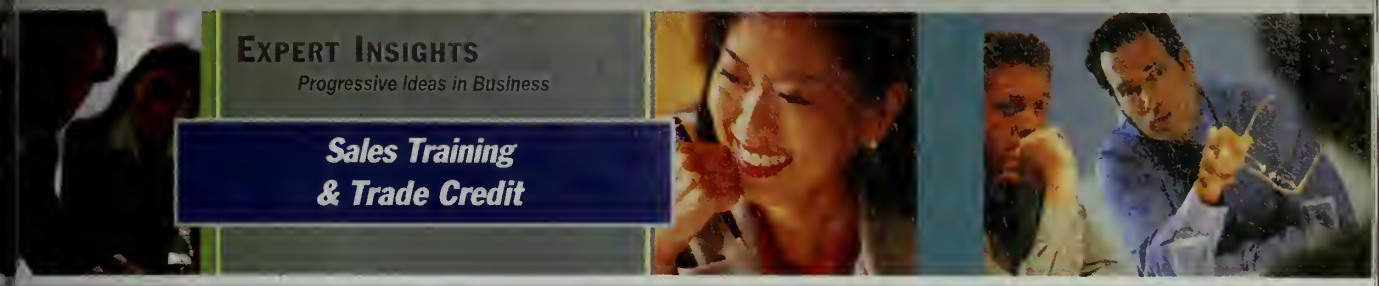

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es Managers: The Forgotten chpins of Business Development

ut question, sales managers play a pivotal role ess development. These individuals select, iotivate, and oversee the professionals driving iness to an organization.

vely maximizing sales managers' efforts understanding the transformation this role is ing. Our research shows that sales managers greater accountability for not only driving t also mediating channel conflicts, ensuring gy adoption, managing distributors and g territories.

ver, despite increasing expectations, organi- have "forgotten" the sales manager by not offering a corresponding increase in support. Selection is generally based on previous sales success rather than management propensity. Sales managers are expected to coach but receive no coaching, and little priority is given to skill development.

The single most significant tipping point in business development is selecting sales managers and equipping them with the skills and support necessary for success. AchieveGlobal research indicates three main competency sets that should factor heavily into the selection process, and be the focus of ongoing support:

• **Communication** dominates a sales manager's time and can include creating a line of sight between team members and the organization, guiding strategy with market reality, managing forecasts, running effective meetings and lobbying for resources.

• **Coaching**, the traditional role of a sales manager, includes assembling the right players, fostering a successful team approach, developing individuals, and proactively managing performance.

• **Strategy development** involves striking a balance between short and long-term objectives, while also building and executing strategic business development plans.

The good news is that companies who provide sufficient support for sales managers in these three areas reduce inconsistencies, improve productivity and ultimately boost the business development activities that generate revenue.

To read the full report, go to www.expert-insights.com/achieve.asp

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otecting Shareholders from stomer Credit Defaults

today are faced with unprecedented credit e to globalization and disruptive business As a result, in the last decade domestic es once believed to be unshakable, such as oile, energy and telecommunications, have very challenging from a credit risk manage- ndpoint. Many Wall Street experts believe w wave of insolvencies across many indus- nevitable in the near term. Furthermore, CFO also must contend with another by- of these macro trends - larger customer ations - even on those accounts which may estment-grade credit quality.

Fortunately, specialized insurance and capital markets alternatives are allowing astute CFOs to sleep better at night, knowing that their major risks can be protected either through conventional or newer, more innovative institutional strategies. These are complex structures and require experts to help guide one through the minefield, but can be very effective in covering against the unexpected (or even the expected) bankruptcy of a customer or vendor. Solutions include:

• Payment protection guarantees on large individual customer(s), underwritten by major financial institutions as the principal counterparty.

• Credit default protection provided by global insurance markets for more routine bad debt protection on a portfolio-oriented basis.

• Political risk insurance covering receivable or investment exposures in developing markets.

To obtain the most comprehensive risk transfer solution (which includes portfolio coverage as well as protection on a single distressed or concentrated customer), the three strategies listed above can often be combined. The cost associated with this risk transfer can be reasonable or pricey, depending on a number of factors, including the probability of default. However the price paid pales in comparison with the potential loss and the subsequent impact to profits and cash flow.

To read the full report, go to www.expert-insights/smyth.asp

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ON THE SCENT The Wayne-DuPage hunters and hounds

Foxhunting, San

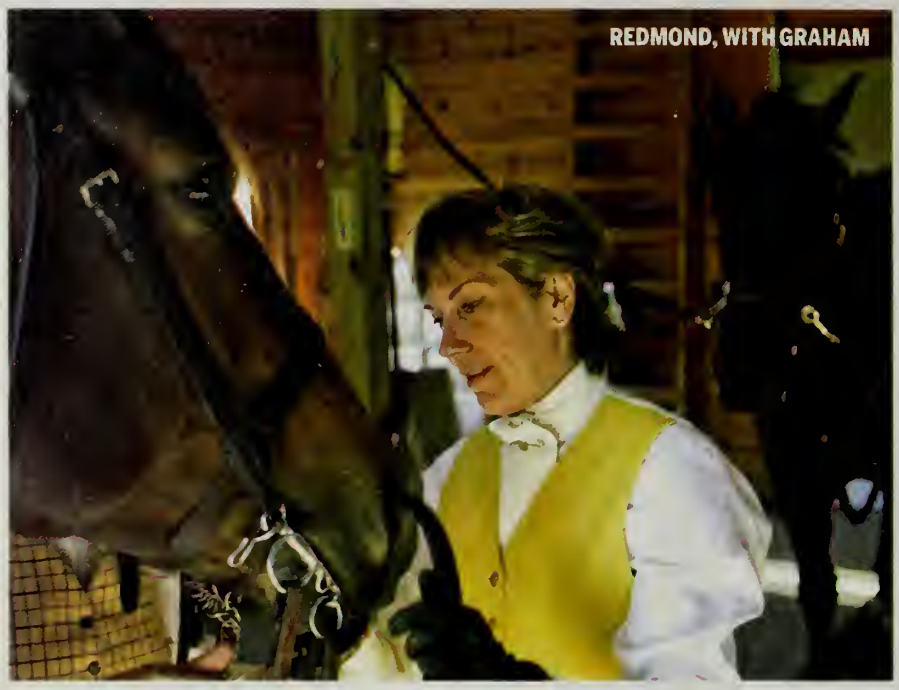
Outside Chicago, in a network of forests and streets, the centuries-old sport is

CHRISTOPHER J. CARNEY

Foxes

n. BY SUSAN BERFIELD

The first thing Andrea Redmond tells me about the fox hunt she has been riding in for the past 15 years is that no actual foxes are involved. The 70 or so riders in the Wayne-DuPage Hunt, held from August through December in what was once countryside west of Chicago, employ the traditional vocabulary of the sport and observe its centuries-old etiquette. Hounds are trained for the chase by the masters of the hunt, and riders known as whippers-in protect and control them on the trails. Field masters lead the riders, who must be turned


REDMOND, WITH GRAHAM

out in white shirts and ascots, vests, jackets (black for women, scarlet for men), jodhpurs, and polished boots. But unlike most of the 171 organized hunts in America, this one has dispensed with tracking a live fox.

Backyards and Woods

INSTEAD, REDMOND, a top executive recruiter at Russell Reynolds Associates, and her fellow riders participate in what's called a drag hunt. It is an ingenious and particularly American adaptation of the British sport, one that disarms critics and limits the experience to a couple of hours while still letting riders give themselves over to the chase. Two set off ahead of the group and lay down the scent of a red fox, squirting a combination of fox urine, glycerin, and water onto the ground. The hounds are sure to pick up the trail, and fast, so animals and riders are in almost constant motion. The lines of scent, about a mile long, take 15 minutes to ride.

On this Sunday the "foxes"—two women wearing red T-shirts—lay down six lines. The hunt begins promptly at 10 a.m., with horses and riders, nearly half of whom are women, in a rough approximation of a circle facing 32 very lively hounds. It will conclude 100 minutes later when one of the masters blows a long, triumphant howl with his horn.

Beyond that, nothing is predictable. The trails, 100 miles in all, run through dense woods, creeks, open fields, a wildlife sanctuary, neighbors' backyards, and the occasional street (where the police chief blocks traffic while the horses cross). The opportunities for a rider to go in one direction and her horse in another are limitless. "You have to have some guts. You're always a little out of control," Redmond says. "That's why it's so exhilarating." This is probably the time to mention that Redmond, 50, has had a motorcycle license since college and was set to try the world's longest bungee jump until her son and husband talked her out of it.

The October morning of the hunt is clear and warm. By 8:30, Redmond is tending to her horse, a six-year-old gelding named Graham. Working alongside her is Nikki Reed, her best friend and one of two masters of the hunt, and Reed's husband, Rob, who has been riding horses since he was 3. They look after Graham; Redmond, who recruite Mark Hurd to Hewlett-Packard, travel too frequently to care for him during th week. Her husband, Bill Ferguson, a rea estate investor, rode a couple of time then gave his boots away.

County Cowboys

THEIRS IS AN EQUESTRIAN communit and the hunters' interests are well rep resented. Thousands of acres of wildlif and forest preserves in DuPage Count are available to them. New developmen must permit hunters to pass throug the property. The pastor in the village Wayne performs the ritual blessing of th hounds. Still, the hunt's organizers an benefactors are always looking for ne trails and often find themselves lobbyin homeowners, especially those just o from the city, for permission to hunt o their land. Each season the club hosts ball to which the landowners are invite and every December the masters giv dozens of bottles of wine in thanks.

Today's hunt has drawn a large grou of riders and observers. The "stirrup cu afterward will be a more extravagant a fair than usual, with cocktails on th hosts' lawn and a buffet lunch in a co verted barn. The riders will be followin trails whose descriptions—Trish's bac yard, BB's creek—suggest a decepti ease. Most of them are narrow paths deep woods. Together with a dozen oth "hilltoppers," I drive from one vanta point to another. Through the forest can hear the hounds barking—or "givi tongue"—well before we can see the ri ers and their horses. Then they rush us in full pursuit. Drag hunters, I lea later, are sometimes called cowboys.

Afterward, Redmond and the ma ters recall particulars of the hunt tha missed. The first line, on roug steep ground, had been terri ing. One of the "foxes" had replace a broken rein with h belt, and the hounds gave cha to a llama on a nearby far And, for the first time, Redmo tumbled off her horse wh he balked at a jump. She sa Graham looked mortified. F Redmond, it was "all part of t fun," and a little port at lun would ease her sore should If she didn't want an adventu she says, she would just ride t trails. "At the end of the hu we always say: 'We have def death once again,'" she tells n with just a bit of bravado. ■

The Tally

A GOOD FOXHUNTING HORSE can cost anywhere between $5,000 and $50,000; most of those in the Wayne-DuPage club are worth between $7,500 to $15,000.

KEEPING A HORSE IN A STABLE can run between $650 to $1,000 a month. If you have your own barn, the monthly cost is still about $350 a month.

MEMBERSHIP IN THE WAYNE-DUPAGE CLUB is $1,000 a year for a family, $750 a year for an individual. The club also raises money, usually about $25,000 annually, by auctioning off photos of the hunt and the right to name the club's puppies.

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Made in the USA

Wisconsin's 50-odd artisanal cheese makers are producing products that rival Europe's best

BY MICHAEL OREY

IF YOU STILL THINK OF WISCONsin as the state that churns out all that bland, industrially produced cheddar and mozzarella, you're not up on your cheeseology. In the last decade the Dairy State has become home to dozens of small producers whose innovative, handmade cheeses are racking up prestigious awards and wowin cheesemongers around the country.

Recently, Murray's Cheese Shop, or of New York's premier purveyors, o fered a class on Wisconsin speciali cheeses that featured seven selec tions. It could easily have include many more. "I could knock your socl off with a great [Wisconsin] chees every day for a solid month," say Steve Jenkins, head cheese buyer Fairway Market, a gourmet grocer i New York.

Wisconsin's 50-odd artisanal chees makers turn out products that ofte echo Old World varieties, with diffe ences due to the local vegetation eate by the cows or sheep and the microo ganisms that work on the cheeses they age. Take Pleasant Ridge Reserv made by former Xerox executive Mil Gingrich's seven-year-old Uplanc Cheese in Dodgeville (uplandschees com). Although modeled on Beaufo a French gruyère-style cheese mac from raw cow's milk, Pleasant Ridg has a complex, nutty-sweet flavor its own. Cave-aged for a minimum four months, it gains intensity as gets older, and by the time it's a ye old it has formed crunchy, flavor-fille crystals common in well-aged chees In 2001 and 2005 it won Best of Sho at the American Cheese Society confe ence. Look to pay about $20 a poun more for "extra-aged."

It's not just the relative newcome like Gingrich who are getting into tl artisanal act. Carr Valley Cheese in I Valle (carrvalleycheese.com) has be in business for more than 100 years. I Mobay cheese offers a playful twist

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Update the Excel spreadsheet, or just finish reading this article?

ıe semi-soft French classic Morbier. /hile the traditional version features vo layers of cow's milk cheese bi-ected by a fine layer of vegetable ash ɔriginally to separate the morning nd afternoon milkings), the thin gray ne in Carr Valley's divides bright hite goat and creamy-colored sheep ıilk layers, which are tasty together or n their own. Carr Valley makes more ıan 50 varieties of cheese, including and-crafted cheddars, some aged as ɔng as 10 years. Mobay prices range om $14 to $20 a pound.

For those partial to Parmesan, Sartori ood's Stravecchio stands up to even ery good Italian varieties (sartorifoods. om). Made in Antigo and aged at least 8 months, it has a robust yet slightly weet flavor that goes as well on an hors 'oeuvre plate as it does crumbled over oup, salad, or pasta. At the 2006 World heese Awards in London, Stravecchio, hich sells for about $11 a pound, vas proclaimed "best U.S. cow's milk heese."

Lovers of more pungent fare can also ınd satisfaction from Crave Brothers armstead Cheese (cravecheese.com), hich makes the mildly stinky but holely delicious Les Frères. Resem-ɔling brie in appearance and texture, es Frères is a washed-rind cheese, neaning that, as it ages, the wheels are regularly hand-rubbed with special cultures that help it develop its earthy flavor. A brochure for Les Frères says it has "the aroma of a forest floor after a fresh rain." Others might use less sylvan terminology, but that should not deter you from trying it.

The brothers Crave (there are four of them) have 600 Holstein cows on their farm in Waterloo, which also turns out a cheese that offers a classy way to end a meal. Their mascarpone (about $6 for an 8-ounce tub) is creamy-rich and delicately flavored. Straight from the refrigerator it has the texture of hard butter, but don't eat it like that. Let it come to room temperature (good advice for all cheese), then scoop up a pillowy spoonful and top it with a bit of fruit or honey. It's sublime. ■

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Ginning Up New Cocktails

Distillers are infusing gin with exotic ingredients to give it more character

BY CHRISTOPHER PALMERI

GIN HAS ALWAYS HAD a distinctive taste, born of the blending of juniper berries and other botanical flavorings. But now gin makers are getting even more creative, adding a spice rack of exotic new ingredients such as cucumber, cinnamon, and saffron. (That last one is an interesting idea provided you can get past the yellow color.)

As odd as these combinations might sound, they represent the latest attempts by distillers to reclaim the spotlight from gin's archrival, vodka. Much to their chagrin, gin has been the wallflower of the current cocktail craze. The more neutral-tasting vodka has edged it out in such famous concoctions as the gimlet and martini, even thoug gin got there first.

As Absolut, Stolichnaya, and G Goose have been doing for years v vodka, gin makers are now infusing t spirit with ingredients to give it n character, then packaging the end res in stylish bottles that carry prem price tags. Bartenders love the ide a gin renaissance because it gives t a chance to stir up new recipes wi liquor they see as more complex t vodka. "We're big gin pushers," says Staehling, bar manager at the Hu Cat, a restaurant in Los Angeles carries five brands of gin and only t vodkas. "You notice it. It contrib something to the drink."

The 19 ingredients, such as corian and violets, are what attract review Paul Pacult, publisher of *Spirit Jou* to Citadelle Gin. Retailing for $2 750 ml. bottle, more than twice wh similar size of Seagram's or Gordon's costs, it was created by the two Fre entrepreneurs behind Cognac Ferr spirit house. "It's good for mixing gin and tonics," Pacult says, because "the quinine in tonic has a very bitter taste. It is best to counter that with fruit and flowers."

SOFT AND BOLD TASTES

SOME OF THE DISTILLERS approacl process with a down-home feel rem cent of the making of old-time bathtub Partners David Hughes and Scott K launched their new D.H. Krahn label conceiving of it in a class at Cornell versity. Hughes claims the small bat he produces are smoother and more pealing to younger drinkers schoole vodka. Currently, it is available only in York and New Jersey. Anchor Bre

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Send an e-mail to your office, or maybe send one to the editor.

owner, president, and brewmaster Fritz Maytag mixes his $30 Anchor unipero Gin in a small copper kettle the rear of his San Francisco brewery. staff fills each bottle by hand. "I think very distinct," Maytag says. "I want to it backbone. You make a martini, and are really tasting the gin."

Mike Miller, owner of Delilah's bar Chicago, is a fan of two softer-tast- gins. Hendrick's, $25 for 750 ml., n Scottish distillery William Grant ons, features cucumber as its most inctive ingredient. Zuidam, $30, is le in Holland, using vanilla beans n Madagascar and the fruit of whole nges, lemons, and limes rather than dried rinds. Each of the nine ingredi- s is distilled separately to give the gin moother, citrus flavor. Miller advises g either brand in straight-up drinks h as martinis and gimlets where the won't get overpowered by mixers.

olks desiring a bolder taste can r Cadenhead's Old Raj Gin. This spirit from Scottish whisky maker liam Cadenhead contains saffron, ich gives it a spicy flavor and yel- ish color. At 110 proof, it's about one-third stronger than even some of its premium-gin rivals. If you want to compete with vodka, you have to make a statement.

New Twist On Gin

e Basil Gimlet

Nikki Ries-Cohen at the ngry Cat in Los Angeles

oz. Zuidam Gin

sil leaves

cup sugar

juice of a whole lime

Mix basil and sugar with half a cup of water. Boil, then simmer for 20 minutes. Strain out basil. Mix ½ oz. of this syrup in an old-fashioned glass with gin and lime juice.

The Champagne Apricato

By Audrey Saunders of the Pegu Club in New York

¾ oz. fresh lemon juice

½ oz. simple syrup (equal parts superfine sugar and water, shaken two or three times until the syrup becomes clear)

1 oz. Plymouth Gin

1 oz. Marie Brizard Apry Liqueur

2 oz. champagne

Measure all ingredients into a martini shaker. Add ice, shake, and strain into an 8 oz. glass. Garnish with slice of apricot or a mint sprig.

The Ex-Patriot

By Mike Miller of Delilah's Bar in Chicago

2 oz. Martin Miller's Gin

4 oz. lemon soda

¾ oz. sweet vermouth

lemon wedge

Pour into a tall glass with ice, squeeze in fresh lemon, stir.

The Gin-Ger Tom

By Jamie Terrel at LAB Bar in London

2 oz. Plymouth Gin

1 oz. fresh lemon juice

1 tsp. sugar

Add ingredients to a highball glass filled with ice and top off with ginger beer or ginger ale.

BusinessWeek online To see a taste test of upscale, flavored gins, watch our TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com to see video clips or to find out where the show airs in your area.

Top of the Line Drop-Top

The new Mercedes SL550 Roadster, with its retractable hardtop and lightning-quick acceleration, is a knockout. At $100,000 plus, it should be. **BY THANE PETERSO**

EXTERIOR From the side the car has the long, sleek, low-slung look of a classic sports car. Sporty, 10-spoke alloy wheels are standard.

MILEAGE The SL550 is fairly fuel-efficient for a performance car: It's rated at 14 mpg in the city, 22 on the highway, and in 344 miles of mainly highway driving, we got 22.1 mpg.

COCKPIT Elegant for sure, with Mercedes' usual impeccable leather and wood appointments, along with well-bolstered, sports-car-style power seats. The seats are almost infinitely adjustable and have an optional massage function.

RETRACTABLE HARDTOP Pull a lever on the center console and a hydraulic pump and 11 computer-controlled cylinders go into action, folding the top down into the top part of the trunk in a mere 16 seconds. Even with the top down, the trunk has 7.2 cubic feet of storage space, enough for weekend jaunts. Unusual for a convertible, there's also an optional $1,920 sunroof.

STORAGE Each door has a big, handy storage bin with a closable top. There are also bins in the front of each seat, as well as behind them. Pushing a button on the back of the seats moves them forward and back again for easy access to the space behind.

TRANSMISSION The car has an efficient new seven-speed transmission that in "comfort" mode takes off in second gear for smooth starts. There's also an Active Body Control system that adjusts the suspension tuning, reducing body roll during hard turns and keeping the car level during rapid acceleration and when you slam on the brakes. As in most sporty cars these days, the automatic transmissio has a manual mode that allows you to the shifting yourself.

SPEED You can go from 0 to 60 in a me 5.3 seconds, thanks to the 382 horsep V-8 engine—26% more powerful than the in the previous model.

PRICE The base price is $95,575, but t Power Information Network figures the average buyer pays $100,533, includi options and a $1,700 gas guzzler tax.

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BY JONATHAN SCHWARTZ

Ol' Blue Eyes Is Live and Swinging

I'VE ALWAYS SAVORED the release of a new Frank Sinatra album. Sinatra, for me, got deeper into the heart of the Great American Songbook than any other singer because he truly felt the words he sang. From the advent of the long-playing record in the early '50s un he stopped performing in 1995, Sinatra made some 35 albums, but only two, including *Sinatra At The Sands*, a 1966 release, were recorded live in Las Veg At his death, in 1998, Sinatra left many great performances in the vaults.

Now we'll finally get to hear four and see one of them in *Sinatra: Vegas*, a box set of four CDs and a DVD to be issued Nov. 7 by Reprise Records and Rhino Records. Two shows are from the 1960s, one from the 1970s, and two from the 1980s.

It's no accident that the vaults were loaded with Vegas material. Sinatra performed there more than any other A-list entertainer of his day, and his style, that sense of tension and danger he brought with him, rubbed off on the town.

Even if you have an ample library of Sinatra, the box set is well worth your time because the man never sang a song exactly the same way twice. The first disc, from the Sands Hotel in 1961, includes *Witchcraft, Young At Heart*, and *You Make Me Feel So Young*. The highlight, however, is a rendition of Cole Porter's *Just One Of Those Things*, which Sinatra had previously recorded up-tempo but here turns into a heartbreaking torch song.

On the second disc, also from the Sands, Sinatra is backed up by Count Basie and his incredible orchestra, conducted at the time by the young Quincy Jones. Part of a tour that Sinatra and Basie did in 1966, this is one swinging show. Basie was an economical pianist, hitting the notes without elaboration in a way that allows Sinatra to find his most rhythmic spirit in such favorites as *Fly Me To the Moon, Luck Be A Lady*, and *Get Me To The Church On Time*.

Move forward a couple of decades, and we hear the master's voice diminished by age but still thrilling. At Caesar's Palace in 1982, Sinatra was moving away from his signature Big Band orchestrations and singing with more intimate instrumental backing. There's just a piano, guitar, bass, and drums on *Night and Day* and piano only on *These Foolish Things*. On stage, he called upon his acting skills to compensate for his loss of singing ability, and so he became the song itself. That's what really comes through, particularly in ballads such as *Hey Look, No Crying* by Jule Styne and Susan Birkenhead *I Can't Get Started*, a collaboration between Gershwin and Vernon Duke. It's as if he were making up the songs as he sang them.

The latest show in the box set, at the Gol Nugget in 1987, features an astonishing dive of music, from Rodgers and Hart's *Spring Is Here*—with a rarely heard Nelson Riddle str arrangement—to Kurt Weill's *Mack the Knif* backed by an enthusiastic big band with an arrangement by Frank Foster. By point it's evident that Sinatra hac the ability to sustain the long line of melody that defined his style c singing. Instead, he was belting c the notes individually, in a chopp more rhythmic tempo.

The DVD is of a 1978 Caesar Palace show. Although the disc was not included in the pre-rele package I reviewed, I did, many years ago, see an unauthorized version of the footage from tha performance. In addition to great singing, it features a frisk Sinatra putting on his tuxedo in his dressing room and phanto boxing backstage.

Thanks to the Sinatra family f issuing this wonderful box set at last. It's something I will cherish.

VIVA LAS VEGAS The $79.95 box set has five shows from three decades

Jonathan Schwartz hosts Fran Place, a channel on XM Satellit Radio, as well as weekend show on WNYC-FM, a New York publi radio station.

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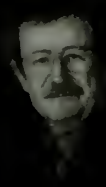

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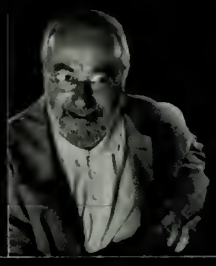

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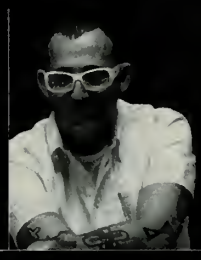

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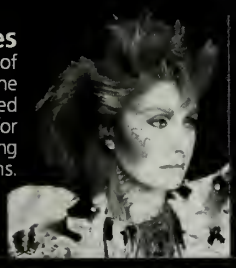

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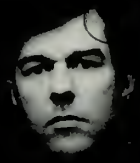

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BY ROBERT PARKER

Wines that Would Make Dad Proud

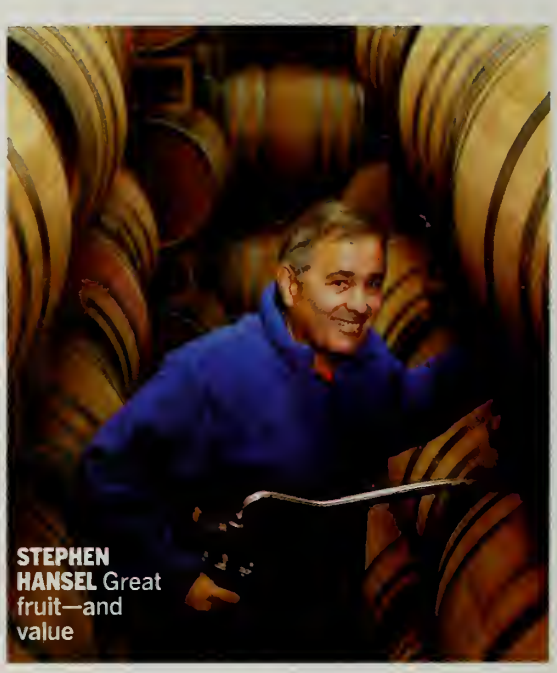
CAR DEALER WALTER HANSEL planted wine grapes on his property in Sonoma County's Russian River Valley back in 1978, and over the years he expanded his vineyards with the help of his son, Stephen. Walter die in 1996, the same year the winery produced its first vintage. Now, the Walter Hansel Winery, run by Stephen, makes fine Burgundian-style chardonnay and pinot noir and sells it at prices that are unbelievable for wines of such quality.

2003 Pinot Noir Estate
88 points. A gamy pinot noir that reveals sweet blue and red fruits, a tasty midsection, medium body, and noticeable elegance. It should drink well for three to four years. $29

2003 Pinot Noir Cahill Lane
91 points. This outstanding wine (of which just 523 cases were produced) reveals a dark ruby color along with a big, meaty, spicy nose of pomegranates, black cherry liqueur, crushed rocks, flowers, beautiful fruit, medium to full body, that ethereal sweetness that pinot noir can offer, and a long finish. It should drink nicely for a decade. $30

2003 Pinot Noir The North Slope
90+ points. The North Slope reveals attractive berry fruit intermixed with earth, smoke, cherry, flower, spice, and subtle wood notes. Fruit-forward and ripe, it is ideal for drinking over the next four to five years. $30

2004 Chardonnay Cuvée Alyce
92 points. Named after Stephen Hansel's mother, the exotic 2004 Cuvée Alyce (only 832 cases produced) possesses a honeysuckle, peach, apricot, and orange marmalade-scented perfume. This gorgeous chadonnay has wonderful fruit and acidity, and a full-bodied, powerful finish that saturates the palate. Consume this wine over the next seven to eight years. $32



STEPHEN HANSEL Great fruit—and value

2004 Chardonnay Cahill Lane
90 points. Exuberant, rich, and light-gold-colored, this chardonnay (about 1,100 cases produced) reveals flamboyant honeyed aromatics of smoked nuts and ripe pineapple. The wine should drink well for four to five years. $32

2003 Pinot Noir Cuvée Alyce
92+ points. Tight and tannic, this wine's saturated ruby/purple color is accompan by a distinctive crushed-rock, sassafras Asian spice, raspberry, and cherry-scen perfume. Big and rich, with high levels o acidity giving it a leaner, more austere st than its siblings, it should be enjoyable f five to eight years. $39

2003 Pinot Noir Hirsch Block Three
90 points. Floral and underbrush notes intermix with pomegranate, clove, and cherry characteristics. It offers a pleasa combination of red and black fruits as well as good acidity, but there's also a distinctive, terroir-driven earthiness tha much stronger in this wine than in the o cuvées. Drink this wine over the next sev to eight years. $45

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or to order his recent book, *The World's Grea Wine Estates: A Modern Perspective*. Yo can also subscribe to Parker's newslett *The Wine Advocate*. Request a sample copy from *The Wine Advocate*, P.O. Box Monkton, MD 21111

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/e

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Can You Trust Your Trustee?

Here's what beneficiaries can do to make sure their money is in good hands. **BY LYNN O'SHAUGHNESSY**

FOR ONE PENNSYLVANIA WOMAN, the familial attachment to Wachovia Bank is strong. Her husband's grandfather helped found it over a century ago in North Carolina in a space once occupied by a Chinese laundry. But that connection to the institution doesn't stop the woman, who asked not to be identified, from expressing dissatisfaction over Wachovia's management of a family trust. Her beef? The portfolio has generated annual returns of less than 3% since the couple began receiving payments three years ago. "It's awkward, I've got to tell you," she acknowledges. "But I really think we should be achieving better results."

While the bank can't comment on the case, Bernard Destafney, a Wachovia managing director who oversees personal trusts in Philadelphia, says beneficiaries don't always understand that trusts must be managed for more than one generation. The aggressive risks that an individual could take with personal funds wouldn't be acceptable in the trust world, and 3% could be a fair return if the trust is trying to preserve its capital. "Generally trusts are very long term so risks and rewards are balanced very carefully," Destafney says.

Unhappy with what you're getting from a trust? Rid yourself of the idea that you're going to take the account to the bank down the street. If you try to dislodge a trust company through the legal system, the institution can typically use the trust's cash to fight you. Besides, law traditionally backs the banks.

Still, you are not powerless. Your bet is to arm yourself with tough tions while remaining gracious. "Si down and talking is the only way," Standish Smith, the founder of H a nonprofit advocacy group for beneficiaries in Villanova, Pa. "W people, get confrontational, the tru just turn off."

Experts say tensions are incre between trustees and beneficiaries days. That's partly because they are st ers. A trust established in a small- bank decades ago could now be p in an institution thousands of miles says Eugene F. Maloney, corporate sel at Federated Investors and a prof of trust law at Boston University S of Law. "Twenty-two mergers late says, "the beneficiary gets handed o call center, and all of a sudden you h recipe for problems."

rust companies aren't required to ate in the same locale where the ac- it was opened. But in nearly all states, must follow a weighty document d the Uniform Prudent Investor Act, h dictates the considerable fiduciary onsibilities institutions must assume n overseeing trust accounts.

iduciary auditors say, however, that trust departments aren't always fol- ng the rules that demand they act in peneficiary's best interests. Common itions include forcing trust accounts ay high commissions or taking pay- ts from outside mutual fund vendors out sharing it with the trusts. "We conducted fiduciary audits of bank t departments, and their adherence duciary standards are as woeful as find in corporate boardrooms," says ald Hagan, chief executive officer at nd/Criss Fiduciary Services in Dal- which advises the retirement plan- industry.

If you want to be a savvier beneficiary, here's what you need to do:

KNOW THE QUESTIONS

Get a copy of the free checklist developed by Fiduciary360 (fi360.com), a fiduciary practices firm in Sewickley, Pa. The list of 68 questions will give you a good idea of what to ask. Don Trone, Fiduciary360's chief executive officer, says the most important thing is to ask for the trust's investment policy statement, which is the blueprint for how the assets are to be managed. Then make sure the trust officers are following it. For instance, if granddad wanted the portfolio to be split evenly between government bonds and stock funds, check to see if that is what's tucked inside the account.

SCRUTINIZE THE COSTS

One sure way to boost income is to reduce the fees. For trusts of $1 million, a ball park figure is 0.75% a year, and the rate comes down as the trust grows. The fee may drop to 0.20% to 0.30% at $10 million, but don't expect them to drop anymore. If you think your trust's fees are too high, take that up with the bank. That's what Smith did for his wife's $8.5 million trust. He got a reduction.

Watch out, too, for the bank's proprietary mutual funds. If the account is paying both fund expenses and an annual trust fee, that's too much, says Roger Krasnicki, a St. Louis attorney and principal of Fiduciary Solutions, a litigation support and trust consulting firm. To compensate for the extra layer of fees, some banks provide a rebate to their trust accounts. If your trust isn't getting one, ask for it.

GET A SECOND OPINION

Fiduciary sleuths—specially trained accountants, attorneys, and investment consultants—can be especially valuable when a bank is preparing to close out a trust and distribute the money once heirs sign release forms. In some of these cases, Stewart Frank, a managing director of the Tillit Group, a fiduciary consulting firm in Bingham Farms, Mich., has been asked to poke around before anybody signs anything. The results can be shocking. "In the first case we looked at it, we found what looked like a couple of million dollars worth of problems that had accumulated over a long period of time," Frank recalls.

What happens if a fiduciary uncovers mistakes? A lawyer can lean on the bank for damages. Since banks abhor publicity, they will often agree to a confidential settlement. Frank says he often sees errant banks reimbursing beneficiaries for 66% to 75% of the lost assets.

LOOK FOR AN ESCAPE ROUTE

Some trust documents include a removal clause that permits a beneficiary to move a trust to another financial institution. That's the option that Nancy Pietrafesa, an artist and writer in Berkeley, Calif., chose after she discovered that she was a co-beneficiary of a trust that her grandfather had established decades earlier. Pietrafesa was stunned to learn that the bank had never changed the original investments in 30 years. "We were able to move the trust and get someone who is much more in line with what my grandfather had wanted," she says.

Few trusts set up years ago have such clauses. But it's a good feature to include if you're establishing one today. That way, your heirs will have some leverage with the bank long after you're gone. ■

BY GENE G. MARCIAL

MORE IMMIGRANTS ARE WIRING FUNDS WITH WESTERN UNION.

UNIVERSAL ELECTRONICS ZOOMS AHEAD ON REMOTE CONTROLS

DNA SEQUENCING TAKES AN EVOLUTIONARY LEAP AT SOLEXA.

Western Union Delivers

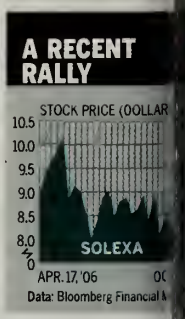
WESTERN UNION (WU) was founded in 1851 as a telegraph operator. But its new stock, which began trading on the Big Board on Sept. 20 after being spun off by First Data, is all about one of today's hottest trends: immigration. Western Union, which offers transfers money at 285,000 offices worldwide, accounted for 37% of First Data's revenues, says Standard & Poor's. WU stock opened at 18 and is now at 21.85. First Data shareholders got one share of WU for each First Data share. Since WU is one of the best-known brands, says S&P, First Data stockholders may stick with WU and sell First Data. "Our share of the money-transfer business has risen from 10% to 18% in four years," says CEO Christina Gold. WU aims to focus on Latin America, Africa, and South Asia for further growth, she adds. Merrill Lynch's Gregory Smith, who rates WU a "buy," says it will continue to benefit as more people migrate abroad seeking opportunity. WU recently sued Arizona for seizing transfers of $500 or more bound for Mexico on suspicion of terrorist financing. WU has won a temporary stay on such seizures. Smith figures WU, which reported third-quarter profits of $258.1 million, or 34¢ a share, vs. a consensus forecast of 28¢, will earn $1.17 in 2006 on revenues of $4.4 billion, $1.13 in 2007 on $4.9 billion, and $1.28 in 2008 on $5.4 billion. Franco Turrinelli of William Blair (it has done banking for WU) says immigration issues are already reflected in the stock; he rates it "outperform."

Universal Electronics: Tuned In to Sirius Radio

THE RAPID ADOPTION OF HDTV and digital gizmos is a boon for Universal Electronics (UEIC), a leading global provider of wireless technology, mainly used in remote-control devices for tv, audio, and computer systems. Its latest product is a handheld media controller designed for Sirius Satellite Radio. It lets subscribers wirelessly navigate with Sirius' radio channels throughout the house. They will be able to listen to Sirius from any stereo system. The Sirius system represents "continued innovation and additional revenue stream for Universal," says Michael Coady of securities firm B. Riley, which has done business with Universal. The stock, up from 15 in June to 21.59 now, is a "buy," he says. Neal Goldman of Goldman Capital Management, which owns 5.6%, says it is cheap for a company with yearly earnings growth of 25%. The stock is worth 30 plus, he says, based on expected profits of $1 a share in 2006 and $1.25 in 2007. Universal, he adds, is No. 1 in a growth business thriving on digital media's continued rapid rise.

Solexa's Progress Is in the Genes

SOMETHING IS NEW in human DNA sequencing: a technology that could speed up the process by 100 ti and that slashes the costs way below those of the cur state-of-the-art system. Solexa (SLXA) has developed its o genome analysis system for gene resequencing, expressio profiling, and small RNA discovery and analysis. The new technology makes Solexa a "leading contender in the nex generation sequencing race," says Un Kwon, a life scienc analyst at Pacific Growth Equities. She rates the stock, which has climbed from 8 in September to 9.91 on Oct. 25, a "buy." Solexa's system is "technically sound and convincing," she says. It's scheduled to be launched by yearend, and orders have come from labs and genome centers, says CEO John West in a recent letter to shareholders. The system has the potential to yield more than one gigabase, or 1 billion bases, of DNA sequence data per run, at a cost of $3,000 to $5,000, says Kwon, vs. 20 million to 30 million bases per run at $10,000 or m John Sullivan of Leerink Swann, which has done banking Solexa, puts the market for Solexa's analysis system at ab $800 million. He rates Solexa "outperform," with a 12-m target of 13 to 15. ■



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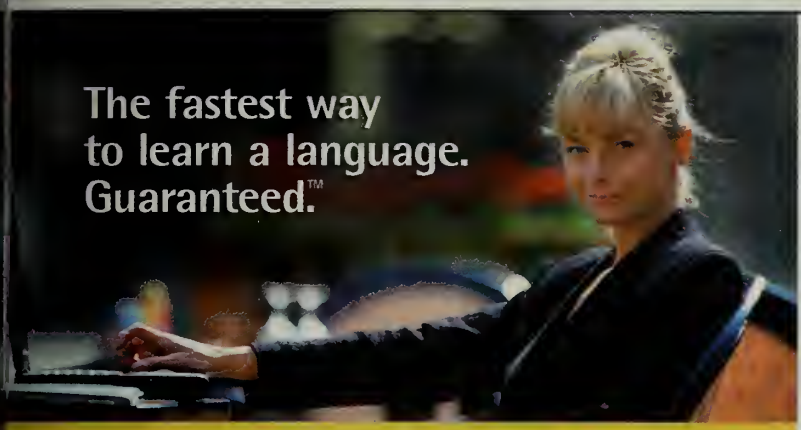

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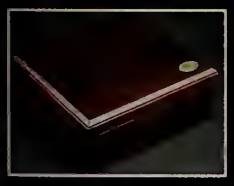

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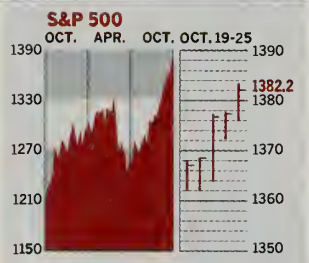
STOCKS



COMMENTARY

Stocks got a boost when the Fed showed little change in its outlook, pushing the Dow further into record territory. Wal-Mart rang up a nice 5.2% gain. The retailer announced a plan to trim capital spending. Airline stocks were grounded. Southwest Airlines reported weak third-quarter results on higher fuel costs. A rebound in oil prices helped energy issues.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	OCT. 25	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1382.2	1.2	10.7	15.5
Dow Jones Industrials	12,134.7	1.2	13.2	16.9
NASDAQ Composite	2356.6	0.8	6.9	11.7
S&P MidCap 400	789.6	0.9	7.0	13.8
S&P SmallCap 600	392.1	0.9	11.8	16.3
DJ Wilshire 5000	13,766.1	0.8	10.2	15.2

SECTORS

BusinessWeek 50*	783.5	1.7	5.6	8.5
BW Info Tech 100**	426.9	1.4	12.2	18.5
S&P/Citigroup Growth	641.2	1.3	7.5	11.6
S&P/Citigroup Value	738.9	1.1	14.1	19.6
S&P Energy	435.8	4.3	16.9	18.9
S&P Financials	476.3	0.2	11.7	19.1
S&P REIT	192.3	0.3	25.7	31.0
S&P Transportation	273.5	3.1	9.5	19.0
S&P Utilities	182.8	2.2	14.5	15.6
GSTI Internet	185.8	4.6	–9.4	2.1
PSE Technology	852.7	0.3	2.0	6.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	OCT. 25	WEEK	% CHANG YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1838.5	1.4	21.6
London (FT-SE 100)	6214.6	1.0	10.6
Paris (CAC 40)	5422.3	1.1	15.0
Frankfurt (DAX)	6264.9	1.3	15.8
Tokyo (NIKKEI 225)	16,699.3	0.3	3.6
Hong Kong (Hang Seng)	18,157.9	0.6	22.1
Toronto (S&P/TSX Composite)	12,341.7	3.1	9.5
Mexico City (IPC)	23,397.7	1.7	31.4

FUNDAMENTALS

	OCT. 24	WEEK AGO	YE
S&P 500 Dividend Yield	1.78%	1.79%	2
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	17.8	
S&P 500 P/E Ratio (Next 12 mos.)*	14.8	14.7	1
First Call Earnings Surprise*	5.25%	1.60%	5

*First Ca

TECHNICAL INDICATORS

	OCT. 24	WEEK AGO	R
S&P 500 200-day average	1290.7	1288.4	Po
Stocks above 200-day average	67.0%	66.0%	Ne
Options: Put/call ratio	0.86	0.83	Po
Insiders: Vickers NYSE Sell/buy ratio	4.13	3.52	Ne

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Steel	28.4	Steel	111.8
Coal	23.3	Agricultural Products	61.8
Real Estate Mgmt. & Dvpt.	21.2	Divsfd. Metals & Mining	50.5
Auto Parts & Equip.	18.8	Department Stores	48.2
Divsfd. Metals & Mining	18.7	Fertilizers & Ag. Chems.	46.6

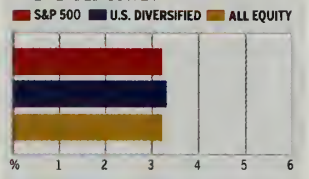
WORST-PERFORMING GROUPS

	LAST MONTH %	
Educational Services	–29.1	Educational Services
Health-Care Services	–9.4	Homebuilding
Airlines	–8.1	Wireless Services
Fertilizers & Ag. Chems.	–7.2	Spclzd. Cnsmr. Serv.
Home Furnishings	–7.1	Internet Software

MUTUAL FUNDS

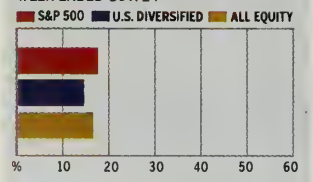
4-WEEK TOTAL RETURN

WEEK ENDED OCT. 24



52-WEEK TOTAL RETURN

WEEK ENDED OCT. 24



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Latin America	11.5	Latin America	46.7
Natural Resources	6.6	Precious Metals	42.0
Real Estate	5.0	Diversified Emerging Mkts.	34.8
Diversified Pacific/Asia	4.8	Real Estate	34.2
LAGGARDS		**LAGGARDS**	
Technology	1.9	Health	9.4
Financial	1.9	Large-cap Growth	9.7
Domestic Hybrid	1.9	Technology	9.8
International Hybrid	2.1	Domestic Hybrid	11.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
DireXn. Lat. Am. Bull 2X Inv.	22.5	Oberweis China Opport.	73.8
ProFunds. Ult. Japan Inv.	15.0	ING Russia A	70.0
DireXn. Japan Bull 2X Inv.	14.9	U.S. Global Invrs. Gold	65.4
American Heritage	14.3	U.S. Glbl. Invs. Prc. Mnls.	64.4
LAGGARDS		**LAGGARDS**	
Ameritor Investment	–50.0	Ameritor Investment	–88.9
ProFds UltSh. Japan Inv.	–13.1	American Heritage Grth.	–40.0
ProFunds UltSh. Emrg. Mkts.	–13.0	DireXn. Sm. Cap Bear 2.5X	–32.5
DireXn. Sm. Cap Bear 2.5X	–10.4	ProFds. UltSh. Sm. Cap Inv.	–29.0

INTEREST RATES

KEY RATES

	OCT. 25	WEEK AGO	YE
Money Market Funds	4.84%	4.84%	3
90-Day Treasury Bills	5.12	5.09	3
2-Year Treasury Notes	4.85	4.84	4
10-Year Treasury Notes	4.76	4.76	4
30-Year Treasury Bonds	4.89	4.89	4
30-Year Fixed Mortgage †	6.28	6.23	6

†BanxQuot

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	3.90%	4
Taxable Equivalent	5.57	6
Insured Revenue Bonds	3.95	4
Taxable Equivalent	5.64	6

THE WEEK AHEAD

PERSONAL INCOME *Monday, Oct. 30, 8:30 a.m. EST* » September personal income is forecast to have grown 0.4%, after a 0.3% gain in August. That's the median forecast of economists polled by Action Economics. Consumer spending probably rose 0.2% after a small 0.1% increase.

EMPLOYMENT COST INDEX *Tuesday, Oct. 31, 8:30 a.m., EST* » Compensation most likely increased 0.9% in the third quarter.

PURCHASING MANAGERS' INDEX *Wednesday, Nov. 1, 10 a.m. EST* » The Institute for Supply Management's October factory activity index probably inched up to 53%, from 52.9% in September.

CONSTRUCTION SPENDING *Wednesday, Nov. 1, 10 a.m. EST* » September building outlays likely rose 0.1%, due to the housing downturn, after climbing 0.3%.

PRODUCTIVITY & COSTS *Thursday, Nov. 2, 8:30 a.m. EST* » Gains in output per hour worked likely hit an annualized rate of 1.5% in the third quarter, after a 1.6% rise in the prior quarter. Unit labor cost growth probably slowed to 3.4%, from 4.9%.

EMPLOYMENT *Friday, Nov. 3, 8:30 a.m. EST* » Nonfarm payrolls are expected to have expanded by 125,000 jobs, after a tepid September gain of 51,000 jobs. The September jobless rate most likely remained at 4.6%.

The *BusinessWeek* production i cooled to 283.9 for the week e Oct. 14, a 10.3% improvement fr year ago. Before calculation o four-week moving average, the slid to 283.6.

BusinessWeek onl

For the BW50, more investm data, and the components of the production index visit www.businessweek.com/extras

ompany Index

index gives the starting page for a story or feature with a ficant reference to a company. Most subsidiaries are indexed under own names. Companies listed only in tables are not included.

IS) 14, 76
ure (ACN) 40
AL) 32
(AZ)54
n (AMZN) 26, 32
AMD) 52
AMR) 16
Brewing 104
American (AAUK) 32
WX) 50
osa Management 32
AAPL) 26
Tec 54
eneca (AZN) 44
Organic Dairy 20

ji 104
f America (BAC) 34
One (JPM) 54
Biotechnologies 44
aire Hathaway
) 32
Matrimony.com 42
tone Group 62
14, 72, 90
g (BA) 20, 54

Bones in Motion 90
Boswell Group 18
B. Riley 114
Buell Motorcycles 71, 72
Callaway Golf (ELY) 54
Canaan Partners 42
Capital One (COF) 34
Carlyle Group 62, 84
Carr Valley Cheese 102
Cayuse Technologies 40
CB Richard Ellis (CBG) 29, 66
CBS (CBS) 14
Cerberus Capital 32
Chery Automobile 44
Chicago Mercantile (CME) 120
Cisco (CSCO) 13, 44, 74, 84
Citigroup (C) 34, 54
CNBC 120
Cognac Ferrand 104
Collins & Aikman (CKCRQ) 54
Command Information 84
Comverse (CMVT) 32
Converium 32
Corporate Library 18
Crave Brothers 102

D, E
DaimlerChrysler (DCX) 32
Dean Foods (DF) 20
deCarta 90, 94
Delphi (DPHIQ) 32, 54
D.H. Krahn 104
DJB Associates 71
Dow Chemical (DOW) 44
Dresdner Bank 54
Ducati (DMH) 71
Endpoint Technologies 74
Enron 32
Equitas 32
Euronext 120
Evercore (EVR) 54

F, G
Fair Share Farm 20
Fairway Market 102
Federated Investors (FII) 112
Fiduciary Solutions 112
Fiduciary360 112
First Data (FDC) 114
Ford (F) 32, 54
Forrester (FORR) 40
France Telecom (FTE) 44
Frost & Sullivan 13

Gartner (IT) 40
Gateway 62
GE (GE) 28
General Atlantic 44
Gilead Sciences (GILD) 54
GM (GM) 32, 44, 54, 90
Goldman Capital Management 114
Goldman Sachs (GS) 16, 54
Google (GOOG) 32, 42, 44, 90
Greenhill (GHL) 54
GSD&M 14

H, I
Haier 52
Harley-Davidson (HOG) 71, 72
Hewlett-Packard (HPQ) 13, 26, 44, 84, 122
Honda (HMC) 71
Huawei Technologies 44
IBM (IBM) 32, 44
ImClone (IMCL) 32, 76
IMS Research 74
Infosys (INFY) 44
Intel (INTC) 44, 52, 74
IntraPace 74

Invitrogen (IVGN) 88
iSuppli 52

J, K
Jeevansathi.com 42
Jefferies 76
Jet Airways 42
JPMorgan Chase (JPM) 34, 54
Kate Spade 76
Kawasaki 71
KB Home (KBH) 76
Kellogg (K) 32
Kleiner Perkins 42
Kmart (SHLD) 76

L, M
Landmark Communications 16
Lazard (LAZ) 54, 62
Leerink Swann 114
Legg Mason (LM) 20
Lehman (LEH) 29, 54
Lenovo (LNVGY) 44, 52
Liberty Media 32
Lloyd's of London 32
Macy's (FD) 76
Martha Stewart (MSO) 76
McAlpine Associates 76
McGraw-Hill (MHP) 34
Mercedes (DCX) 106
Meridian Automotive 54
Merrill (MER) 54, 114
Metaldyne 54
Microsoft (MSFT) 42, 44, 50, 76
Mitsubishi 74
Moody's (MCO) 66
Morgan Stanley (MS) 54
MSN India (MSFT) 42
Muriel Siebert 18
Murray's Cheese Shop 102
Myogen (MYOG) 54
MySpace (NWS) 94

N, O
Navteq (NVT) 90, 94
NBC Universal 14, 28
NEC (NIPNY) 44
NeighborCare (OCR) 54
News Corp.(NWS) 32
Nielsen 76
Nike (NKE) 32
Nokia (NOK) 44, 74, 90
Novartis (NVS) 13
NYSE (NYX) 18, 120
Oak Pacific 44
Omnicare (OCR) 54

P, Q
Pacific Growth Equities 114
Parella Weinberg 54
PepsiCo (PEP) 13
Pernod Ricard 104
Pfizer (PFE) 54
Philips Electronics (PHG) 74
Piper Jaffray (PJC) 71, 90
Polycom (PLCM) 13
Portales Partners 34
Primedia (PRM) 62

Prism Business Media 62
Quadrangle Group 54
Quantum Fund 72
?WhatIf! The Innovation 44

R, S
Ranbaxy Laboratories 44
Ripplewood 32
Roku 26
Roland/Criss 112
Rosenergoatom 89
Royal Philips (PHG) 44
Samsung Electronics 74
S&P (MHP) 34, 114
Sartori Food 102
Schwarz Pharma 54
Sears (SHLD) 76
Seiko Epson 74
Shaadi.com 42
Sharp (SHCAY) 74
Sinovac Biotech (SVA) 44
Sirius Satellite (SIRI) 114
Slim Devices 26
Solexa (SLXA) 114
Sonos 26
Sony (SNE) 44
Sprint Nextel (S) 90
SPX 37
Starcom USA 76
Stonyfield Farm 20
Sun-Times Media (SVN) 54
Suzuki 71

T, U
TAL Apparel 44
Thomson (TOC) 37, 54
TI (TXN) 44, 74
Tillit Group 112
Time Warner (TWX) 54
TopCoder 50
Torto Wheaton (CBG) 66
Tower Automotive (TWRAQ) 54
Tribune (TRB) 32
UCB 54
Universal Electronics (UEIC) 114
Uplands Cheese 102

V, W
V&S 104
Verizon (VZ) 84
Verizon Wireless 90
Vimicro (VIMC) 44
Wachovia (WB) 13, 112
Wainhouse Research 13
Wal-Mart (WMT) 32
Walter Hansel Winery 110
Wasserstein 54, 62
Western Union (WU) 114
William Blair 71
William Cadenhead 104
William Grant 104
WorldCom 32
Wrigley (WWY) 32

X, Y
XM Satellite (XMSR) 108
Yahoo! (YHOO) 28, 32, 42, 76

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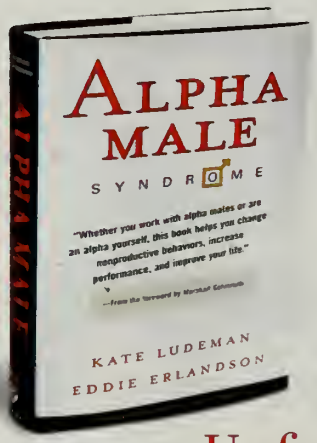
When Top Dogs Need Leashes

ALPHA MALE SYNDROME
By Kate Ludeman and Eddie Erlandson; Harvard Business School Press; 276pp; $26.95

In May, 2004, Kate Ludeman and Eddie Erlandson made a splash with their *Harvard Business Review* essay "Coaching the Alpha Male." The authors' thesis: The top ranks of business are filled with highly intelligent, confident, and successful men who demand to be in control—but whose impatience and drive can also hurt their companies. As a result, they asserted, these men and their beleaguered teams often need a little group therapy. The Texas executive coaches omitted women from their analysis, noting that even the most ambitious females rarely come on so strong as typical alpha males.

Now, Ludeman and Erlandson have expanded their idea into a book, *Alpha Male Syndrome*. Unfortunately, the argument that worked well in an article wears thin when stretched over 276 pages. Still, the volume, targeted at both alphas and their sometimes apprehensive co-workers, offers some useful if commonsensical tips.



A key problem is the authors' revised definition of an alpha male. The *HBR* article clearly focused on domineering top dogs. Here alphas take on many forms—the charismatic commander, the lofty visionary, the data-driven strategist, and even the disciplined executor. While the authors note that alphas are always marked by "an overlay of aggressive intensity, energetic persistence, and competitive drive," their broad categories could include almost everyone in business. Moreover, they now muddy the waters further by making room for alpha females: Among others, former Hewlett-Packard CEO Carly Fiorina makes a brief appearance.

Like the *HBR* piece, the book emphasizes the importance of coaching, particularly so-called 360-degree assessments, where executives get feedback from peers and underlings on the impact of their behavior. But leaders who have shot up the career ladder are often all too conscious of their many assets and resist exposure to blunt, unflattering comments. The authors add that "a great many alpha males see coaching as a soft, touchy-feely fad with little substance, like aromatherapy." Luckily for the authors, once converted, alphas apparently become a coach's dream. "They commit to the process fully and follow through with sucl discipline and tenacity that the impact on them and thei organizations is profound."

The book's many examples give it needed grounding. Ludeman and Erlandson, both of whom consider themse alphas, clearly empathize with their ambitious subjects. I particular, they have a soft spot for Michael Dell, a client theirs who, along with his senior staff, comes up repeated A "visionary alpha with a strong strategist arm," Dell onc had difficulty connecting emotionally with others, the aut say. But at Ludeman's prompting, he decided to discuss c workers' negative feedback concerning him at a 2001 anr executive meeting. His candor, say the autho boosted executive cohesion and revitalized th company's top ranks.

In essence, the authors build a case for the importance of listening, sharing, and generally being nice. They devote a chapter to teams that include alpha males, because a that testosterone can work at cross purposes Even smart, innovative alpha thinkers can be a problem, generating more ideas than a tea can act on. True teamwork, to the coaching duo, is embodied in a women's basketball te (why just the women's version isn't explaine while cutthroat alpha-driven teams are typifi by what's seen on Donald Trump's TV show *The Apprentice*. So what doe good alpha do? "Respect th opinions of others even if t don't agree with them," say authors, while "self-serving alphas use their verbal skil distort and disparage."

Useful, if not startling, advice for alphas and their put-upon co-workers

Like any good coach, the authors also look at alphas' away from the office. Amon their suggestions: a regular fitness program (although t warn against competitive sp such as marathon squash o full-court basketball, which only feed adrenaline levels). And alphas need to take special care not to bring their m demanding traits home with them. The authors' tips: Le to share responsibility (can alpha males do dishes?), stop blaming, listen, and don't make marriage a power strugg

It's perfectly sound advice. Most readers already know boorish behavior in the corner suite doesn't cut it. But th also understand that if you want to get ahead, many alph traits are an advantage. Sure, get a coach and loosen up. even Ludeman and Erlandson acknowledge that, despite some drawbacks, an alpha male is what you want to be.

–By Diane E

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WITH **MARIA BARTIROMO**

Big Board, Big Challenges

JOHN A. THAIN, who took the New York Stock Exchange public earlier this year, is racing to keep the Big Board competitive. Partly because of restrictions imposed by the Sarbanes-Oxley Act, companies are choosing to list in London, Hong Kong, or elsewhere. That's why the NYSE's proposed $10.2 billion takeover of Euronext, which operates the Paris, Brussels, Amsterdam, and Lisbon bourses, is seen as crucial. Since I talked with Thain, the pressure has only grown more intense, especially with the proposed merger on Oct. 17 of the Chicago Mercantile Exchange and the Chicago Board of Trade.

When do you expect to close the deal with Euronext?
First quarter of 2007.

Deutsche Börse says it has a better bid on the table. Why should shareholders choose the NYSE?
You have to analyze the nature of the bids. Our bid makes much more strategic sense for the long term.

What happens if the shareholders decide that Deutsche Börse is a better deal? What is your Plan B?
The shareholders will get to vote yes or no on the NYSE-Euronext deal, and I believe they will vote yes because it makes economic sense to do so. Remember when we were having the run-up to the NYSE-Arca deal, and there was a debate? [Archipelago is an electronic exchange for emerging companies bought by the NYSE in February.] In the end, 95% of the shareholders voted for it.

Once the deal is complete, where will much of the cost savings and layoffs come from—the U.S.? Europe has such strict labor laws.
The biggest single cost savings is on the technology side. Between us and Euronext, we spe $650 million on technology. We will save about $250 mill of that. The cost savings will come from the technology si not from headcount reduction.

Do you consider the Chicago Mercantile Exchange a competit
Not directly a competitor, because they are in a different mix products. Over time, they will become more of a competitor. futures business is a very good business. It has better margir than the cash business. Most of the CME's products are grov at rapid rates, and it's hard to compete with them because o you have an established futures product, it's very difficult to create new products that compete directly with them.

Why are an increasing number of global companies choo international exchanges over U.S. exchanges?
The large global IPOs have not been coming to the U.S. It do mean we are not getting international listings. In fact, we But it's the big IPOs that are avoiding the U.S.

How significant has SarbOx been in driving compa away from American stock exchanges?
It is one of the significant reasons, but not the only o

Did Congress go too far?
It's not the law itself. The law was a good law, and it came at an important time and did improve the corporat governance structure. It's not even 404....[Section 40 requires companies to test controls assuring acc of publicly reported financial information.] It's the way 404 was implemented. Having good internal controls is important, but w needs to happen now...is more of a risk-ba approach, and the costs have to be balanc better against the benefits.

The market is hovering around record l but some are skeptical. How do you a critics who say the little guy can't win
If you look over any significant period of time, stocks have been a very good investment for individuals as well as institutions. The way ordinary people should invest is picking good compa with good products, buy [the stock], put [it] away for a long period of time

Maria Bartiromo is the anchor of C Closing Bell.

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IdeasTheWelchWay

BY JACK AND SUZY WELCH

A Dangerous Division of Labo

How do you explain the Hewlett-Packard mess?

—Edward Yingling, Phoenix

First, by observing that organizational crises often seem to make smart and sensible people do foolish things, like panic and point fingers. That said, who did what wrong at HP still remains unknown; perhaps as the fog of war lifts, people will eventually understand which individuals ultimately own the blame in this unfortunate episode.

Lost in all the current intrigue, though, is the fact that the HP mess once again confirms (for us, that is) that governance "experts" have it wrong when it comes to one of their favorite causes, the separation of CEO and chairman. Indeed, some self-designated watchdog groups that rate corporate boards assign multiple goodie points for such a split. And yet, despite the high-minded proselytizing about why the roles should be distinct, HP proves how damaging it can be when they are.

The reason is that all companies, no matter what their size or industry, operate best with managerial clarity—when people know which way the company is going and who is leading the charge. At HP, employees should have had one boss in CEO Mark Hurd. A respected industry veteran, Hurd had his strategic goals and a team motivated to deliver them.

But there was another boss, too, board chairwoman Patty Dunn, who was reaching out to some employees with her own agenda and deploying company resources. That meant HP was being run by two leaders, a dynamic which can easily lead to confusion, or worse, to employees shopping around for the answer they like best. Ironically, while all this was going on in early 2006, a respected national rating service awarded HP one of the best governance scores in the high-tech industry, and Dunn herself was asked to give a keynote speech at a major conference about governance best practices.

But the situation at HP was untenable. A board's job is not to micromanage a company; they just don't have the time to know enough. Yes, a board should have a lead director, to pull the members together and create an independent voice. But a lead director is not an alternative CEO. Instead, the board, united by the lead director, has one main role: It should use its collective wisdom, judgment, and common sense to pick the CEO and provide that person with constructive challenge, insight, and support. The board must debate and buy into company direction, and, more importantly, monitor that direction with trips alone—without the CEO—to determine whether what it is hearing in the boardroom matches the reality of what people in the field are feeling. The board h decide whether the CEO is delivering results and doing it right way. If so, the board needs to redouble its support, a if not, it must make the tough choice for change.

At HP, little of this appears to have been going on; the b operated like a rogue cell, both meddling and forming fact and in doing so, it undermined the company that it should have been bolstering. If there had been one boss in charge, the person of CEO and chairman, coupled with a good lea director, chances are it wouldn't have happened. And perh it is time for companies and the governance police—with t misguided point systems—to confront that reality.

> Good corporate governance comes down to a lot more than a point system

I spend about 35% of my time attending mandatory but not always useful meetings. Is that excessive?

—Jonathan Stiffy, Washingto

Meetings are a necessary evil in business, with heavy emphasis on "necessary." They give a company its rhyth and even in this connected world, people sometimes hav be in the same room to get on the same page.

The problem with too many meetings, though, is that they play out like a slow-m show, featuring the droning incantation of a zillion PowerPoint slides. No wonder the only person ever happy about a meeting is person calling it. Everyone else just mutte about the tedium—until it's time for their "exciting" meeting.

If you're a boss, the fix is simple. Stop making meetings forums for people to display overwhelming proof of how sma they are. Kill the litany of data-packed sli showing how much information fits on t head of a pin. Instead, insist on meeting where only a few slides are presented, all them designed to stimulate real debate a draw everyone into the game.

If you're not a boss, break the mold and make your ow presentations models of simplicity and clarity. You may surprise some, but you'll win over more. The silent majo is asking your question, too; they want presentations to conversations, not deliver a mind-numbing end to them.

Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their week podcast, go to www.businessweek.com/search/podcasting.htm*

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Amazon's Risky Bet

CEO Jeff Bezos wants to run your business with his eb technology. Wall Street wishes he would just mind the store.

BY ROBERT D. HOF (P.52)

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adison Avenue's New Insider
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arassment in High Places
panies are sending "boundary nged" bosses to therapy

bal Business

etting Mercedes Back Up to Speed
us on quality and cost has the y carmaker humming again

ussia's Green Crusader
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ecial Report

A Harvest of Energy
ers are investing heavily in native fuels. But how much of the n can really run on corn?

What Good are Biofuels?
they're made, how green they truly nd how they affect food supplies

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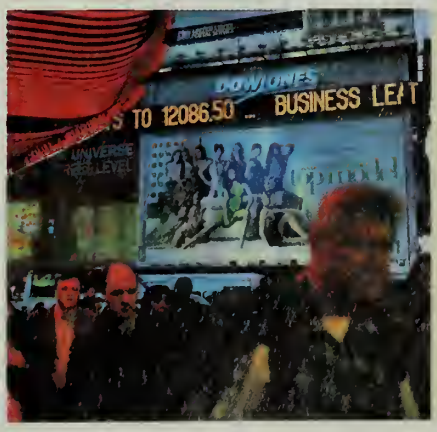
Cover Story

52 Amazon's Risky Bet Here comes Jeff Bezos, back with a big idea. Now he wants to run your business, renting out just about every operation that powers his $10 billion online store, from rack space in warehouses to spare computing capacity on thousands of servers. But if techies are wowed, Wall Street wonders: Is the CEO just digging another money pit?



NEWS & INSIGHTS

34 The Not-So-Big 12,000 Investors are blasé about the Dow. In fact, for many, stocks barely rate a mention. Blame price weighting, an outdated valuation method that gives higher-priced shares undue influence. Yet the problematic numbers may mean the market is at the start of something big

CONTENTS

91 | GOLF DIGEST

60 | FUEL FARM

Managing

72 A Korean Upstart in MySpace's Face
Cyworld could be a social networking sensation in the U.S. if it learns the ropes

Environment

74 Coal's Dirty Little Secret
Coal-fired plants once had the economic advantage over solar power. No more

Finance

76 Why Bankers Are Seeing Bears
Stocks have been strong this year for banks of all sizes, but now earnings are under assault

78 A Teetering Mortgage Market
The industry has met its perfect storm

InfoTech

80 Dave Duffield's New Workday
The software legend returns with a plan to exploit Web-based technology

Sports Biz

84 How Tony Hawk Stays Aloft
It's no mean trick to remain a sports hero to teens and preteens as you near 40, but this skateboarder manages it

Golf & The Business Life

91 Smart New Places to Retire
Golf-fixated baby boomers are looking for less traditional places to settle down. Here are 18 hot spots

105 Courses and Campuses
Some college towns offer great golf along with cultural stimulation

108 A Piece of the Action
Golf's rich history makes it fertile ground for collectors

112 The Golf Industry: Not for Sissies
Equipment sales are flat, endorsements are hard to come by, and marketing in a fragmented business is a sand trap

118 Scorecard as Calling Card
A good golf game can serve as a special entrée when you solicit new business

Executive Life

122 Parker on Wine
Six ready-to-drink "Australian fruit bombs" from Sparky and Sara Marquis

Personal Finance

124 Shining a Light on Bonds
E-brokers are adding more price data and cutting the fees for trades

Columnists

24 Steve Wildstrom: Tech & You
Internet Explorer 7 vs. Firefox and O

26 Jon Fine: Media Centric
Private equity + media: And you thought conglomerates were tough

29 Jim Cooper: The Business Outloo
Housing's slump may not be so bad, consumer spending is strong anywa

126 Gene Marcial: Inside Wall Stree

136 Jack and Suzy Welch: The Welch
High-performing jerks? They gotta

Ideas

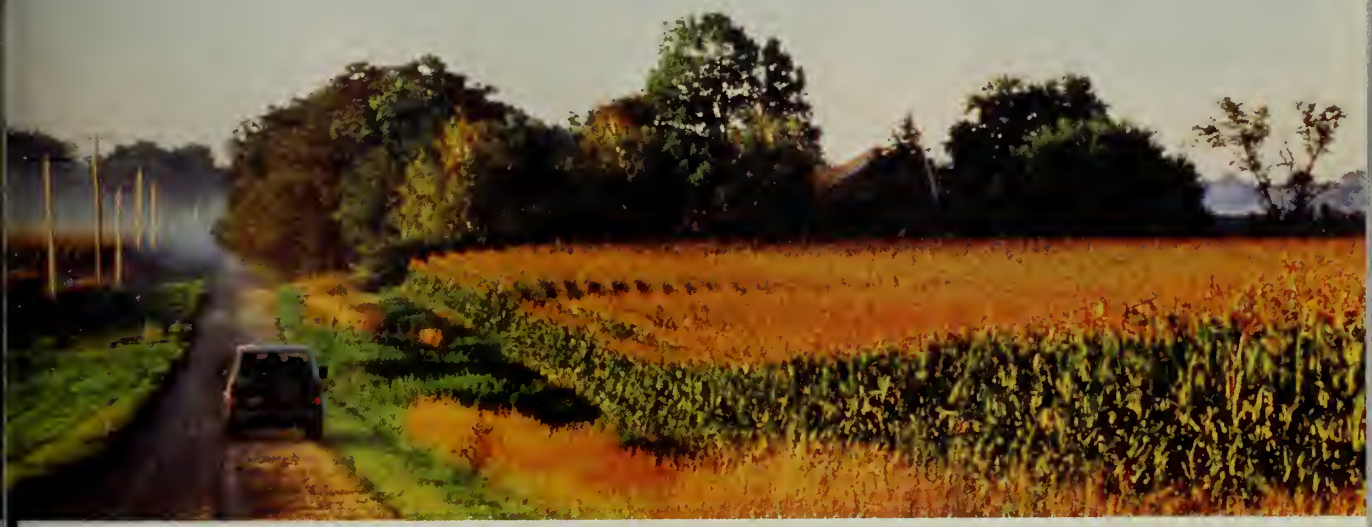
132 Books
Wozniak with Smith: *iwoz: Compute Geek to Cult Icon: How I Invented the Personal Computer, Co-Founded App and Had Fun Doing It*

134 Outside Shot
What's right with Sarbanes-Oxley

Features

9 UpFront
18 Readers Report
22 Corrections & Clarifications
128 Figures of the Week
130 Index to Companies

Who is helping two-thirds of new US ethanol plants meet the nation's future energy needs? We are.



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Young, Fearless, and Smart

This crowd is going places. Meet the brilliant young minds behind some of the most promising startups in the U.S. toda They're fearless, determined, and all age 25 or under. You can read about their ventures in BusinessWeek.com's secon annual Special Report on **Best Entrepreneurs Under 25,** and then **vote for your favorite.** Check out our **Tip Sheet with resource** for any young person starting a business today, whether it's your first or one among many. You also can find out why entrepreneurship has become increasingly attractive to the younger crowd and learn how to avoid common stumbling blocks. Be sure to tune in to **a podcast on what really motivates** young entrepreneurs, and weigh in on the age-old question Are entrepreneurs born or made? Then catch up with **last year's five winners** (who were selected by our readers) and discover where they are now. To see all this and more, go to **www.businessweek.com/go/06under25**

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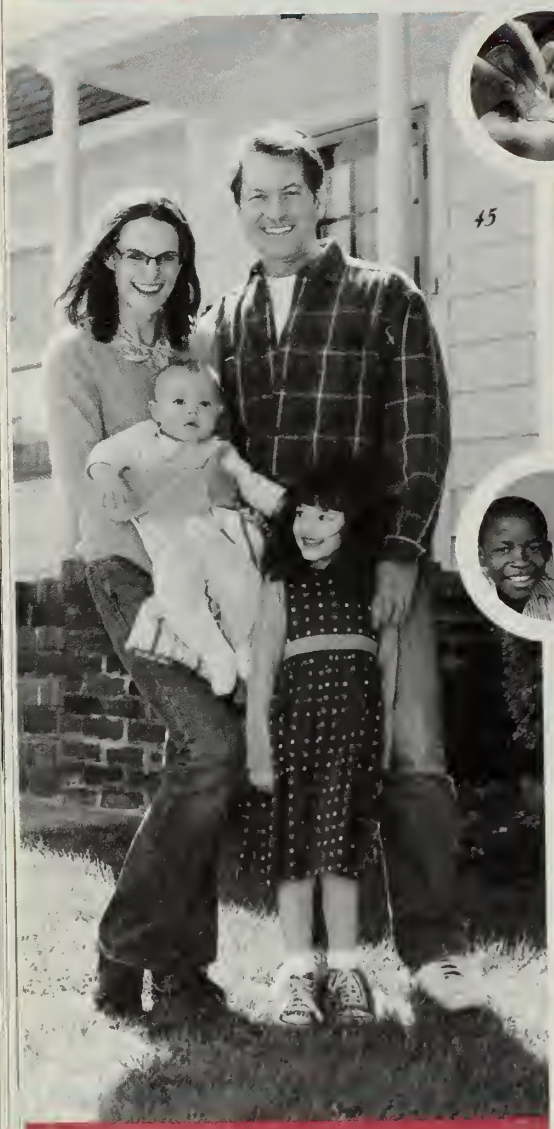

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JP Front

"There has been cost-cutting in the chemical industry and in the petroleum industry. Has it gone too deep?"

–Carolyn Merritt, chairman of the U.S. Chemical Safety & Hazard Investigation Board, on the 2005 fire that killed 15 workers at BP's Texas City refinery, as reported in the Houston Chronicle.

ITED BY DEBORAH STEAD

LECTIONS

USINESS ANTS ITS AY IN COURT

RE'S MORE at stake than trol of Congress on ction Day. Corporate ups have been investing vily to elect business-ndly judges in 26 races in tates, a blitz that may break r spending record on 33 cial races in 2004. nding on TV alone in state reme Court paigns has 8.3 million, rom $8 million spent at point in 2004. That's the ng of New York University school's **Brennan Center ustice** and **Justice at Stake,** groups tracking judicial paigns.

s contributions from ical parties in these s have plummeted, from ost $1.6 million in 2004 day's $54,200, plaintiff lawyers and groups like the **U.S. Chamber of Commerce** and the business-backed **American Justice Partnership** have filled the void, to the tune of $1.3 million. So far this year, business groups account for 94% of third-party TV-ad spending, up from 76% two years ago.

The spending strategy took root in 2004. That's when, after decades of losing big lawsuits before judges who had cozy relationships with local lawyers, business decided that high-priced legal talent wasn't enough. Trade groups stepped in, contributing $21.5 million (almost double what lawyers and labor groups ponied up) to the campaigns of friendlier judges. It's an alarming trend, says associate counsel James Sample of the Brennan Center, because outside groups are more likely to air attack ads. "The nastiness factor goes up," he says. *–Lorraine Woellert*

CORNER OFFICE

Analyst's Report: You're Fired

WALL STREET analysts are crunching careers as well as numbers. If half of those covering a company downgrade its stock—say, from "buy" to "hold"—the odds increase nearly 50% that the CEO will be spending more time with the family within six months. And if just one analyst drops coverage of a company, the chance that its chief will be gone within a year goes up almost 40%.

That finding comes from research conducted recently by Margarethe Wiersema, a management professor at the Jesse H. Jones Graduate School of Management at **Rice University,** and Mark Washburn of the **University of California at Irvine,** who studied Fortune 500 companies from 1996 to 2000. The "analyst effect," they say, went beyond the impact of bad performance: The study controlled for the effects of dropping revenues and profits.

The results may resonate with those concerned about the high CEO turnover these days. (So far this year, 1,112 chiefs have left their posts.) "Our findings suggest that boards are not focused enough on fundamentals and too focused on Wall Street," Wiersema says. *–Nanette Byrnes*

E BIG PICTURE

TWO-THIRDS of chief marketing officers at ding retailers expect this year's holiday es to exceed those in 2005, when sales e 6.1% over 2004. Here's how they voted on which external factors are most likely to crimp that spending:

Rising energy costs	52%
Rising interest rates	28%
Slow housing market	14%

Data: The 2006 Seidman Retail Compass survey

UP Front

BRIGHT IDEAS

NOW THAT'S COMMUTER POWER

How many Japanese commuters does it take to light a bulb? On Oct. 16, **East Japan Railway,** or JR East, began testing rubber floor mats that generate electricity when walked on. The mats, which will be at several turnstiles inside Tokyo Station for two months, work by converting vibrations into energy.

For now, a mat produces just 100 milliwatts with each commuter's steps. With about 700,000 commuters entering and leaving Tokyo Station daily, that translates to about 70 kilowatts of power—barely enough to light a 100-watt light bulb for 10 minutes. Officials say if the technology gets refined over the years those stomping feet could generate much more, providing electricity for a train station's lighting and other needs. "The mats could power machines and signs that don't require much energy," says JR East spokesman Takaaki Nemoto. "But that's far into the future."

–Kenji Hall

MARKETING

SEEKING A FORTUNE IN SHANGHAI

AARON LANDIS, co-founder of a Shanghai startup called **Enjoy China Holdings,** thought he had hit on the perfect ad campaign for his newly launched **Enjoy Classifieds,** a kind of **Craig's List** for expats and yuppie Chinese. The idea, hatched last month, was to use Shanghai restaurants and bars to distribute fortune cookies whose "fortunes" advertised the site. A slip of paper with "You will soon find your true love" would contain the URL for the site's personal ads. "Your talents will soon be appreciated" would carry the address for the jobs site.

Landis, a 35-year-old St. Louis native who has lived in Shanghai for the past three years, knew that fortune cookies aren't really a tradition in China. "We think it's Chinese, and they think it's foreign," he says. Still, he clung to the idea. "I read somewhere that 99% of the people who receive fortune cookie messages actually read them," he says.

But finding a local supplier was tough. At one point, after hunting without success, he and his partners (a Belgian and an Australian) considered importing the cookies from a New Jersey factory. They even thought of buying ovens and baking the cookies themselves. In need of a cookie for promotional material to show restaurant owners, Landis contacted an ex-girlfriend, who FedEx'd him fortune cookies from a Chinese restaurant in Washington D.C. Finally, the team found a noodle factory in Guangzhou, close to Hon Kong, that sold fortune cookies for export to the U.S and Europe. They bought 10,000.

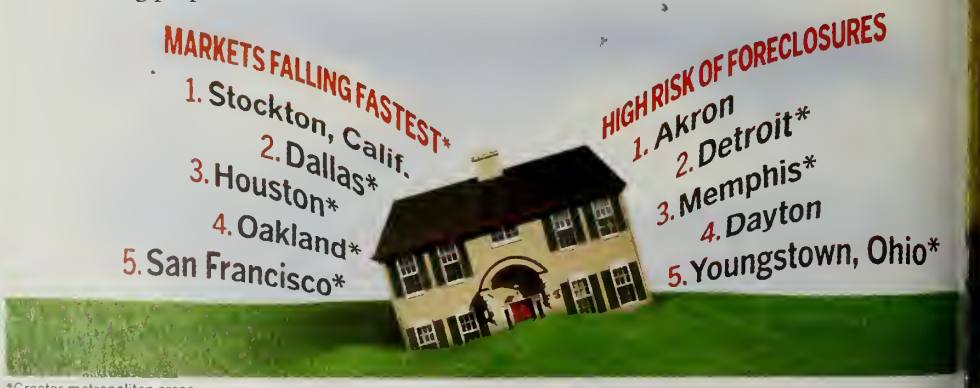
"It's working," Landis say of the promotion, which ran about 40 restaurants and ba and cost about $2,500. Enjo Classifieds, he says, now has "300% more postings" than its two bigger local rivals. "It a way to really reach people and surprise them," he says. Besides, "we're giving them cookie." *–Bruce Einhorn*

THE HOME FRONT

WHERE YOU'LL GET THAT SINKING FEELING

HOMEOWNERS are particularly vulnerable to falling house prices, foreclosures, and, thus, mortgage-lending fraud in two kinds of markets these days, says Mark Fleming, chief economist at **CoreLogic,** a Sacramento real estate consultant: in job-distressed regions and in once-feverish real-estate markets gone cold. Fleming pinpoints the U.S. cities where prices are decelerating the fastest (such as formerly white-hot regions in California and Texas). He's also identified places wher job losses in the auto and textile industries will deepen housing distress. In Memphis, for instance, foreclosures now outpace the national average by a factor of six.

–Mara Der Hovanes



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UPFront

CASHING OUT

IS THE SMALL-BANK BOOM OVER?

THE PAST FIVE years or so have been heady times for community bank startups. As beneficiaries of the fallout from the last wave of big-bank mergers, they've gained disgruntled customers seeking first-name service with a smile. As a result, community bank IPOs, and their stocks (primarily traded over the counter), have soared: Of the 42 banks that debuted in 2000 and 2001, 16 have produced triple-digit cumulative stock returns over the past five years, including South Carolina's **Coastal Banking,** up 262%, and **Pinnacle National Bank** in Nashville, up 793%.

With those kinds of returns, who wouldn't want to start or invest in a new bank? In 2002 upstarts raised some $500 million to open 74 community banks. Last year those numbers leaped to a record $1.9 billion and 134 bank launches, according to Cincinnati-based **Financial Stocks,** which manages a private-equity fund. But with economic growth and the housing market both sliding, the $1 billion raised so far this year for such new ventures may be late to the game, warns John Stein, president of Financial Stocks. "Everyone is looking at how well people did in the past and throwing a lot more money at this at a much more difficult time," he says.

Indeed, cashing out may be the smarter option now. So far this year 10 banks with charters less than 10 years old have sold for lofty prices. New York's **Great Eastern Bank** and Arizona's **Choice Bank,** for example, were bought for eye-popping prices equal to more than 40 times their trailing 12-month earnings per share and about 2.5 times book value. This may only encourage more investment, despite the bad timing. "Other small banks are going to see an opportunity to start up," says Jacqueline Reeves at the investment bank **Ryan Beck & Co.** *–Mara Der Hovanesian*

OVEREXPOSED

TO WARN students about the dangers of posting a racy or over-revealing profile on sites like Facebook.com, Indiana University at Bloomington has tacked up a thousand flyers around campus. The posters, each proclaiming "I Facebooked you!" (above), remind students that prospective employe among others, can view some or all of thei profiles. (Facebook.com no longer limits membership to those with dot-edu e-mail addresses.) "A lot of times they're putting stuff up there to make themselves look go in front of their friends," says academic adviser Cindy Moore. "We wanted to make our students aware that the entire world c see what's there." *–Lindsey Gerde*

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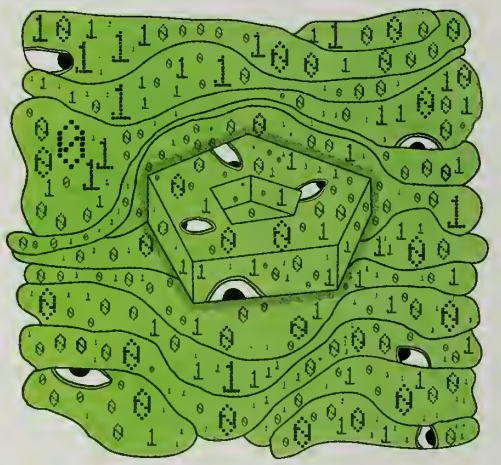
THE PENTAGON

RETHINKING THE SAFETY OF SOFTWARE CODED OVER THERE

UNTIL NOW, the debate over the exodus of software programming to places like India has mostly focused on whether lower costs are worth lost American jobs. Now, however, a new hot-button issue is surfacing—about whether such outsourced programming is a threat to national security.

A Pentagon task force is in the final stages of preparing recommendations on how to deal with the fact that some software the military buys from American companies is coded offshore. The task force is part of the **Defense Science Board,** an advisory group made up of volunteers from the military and industry. While the task force's deliberations are secret, the conversations its members have been having with outside experts are raising concerns in the tech industry about what the recommendations will be.



"We recognize that there are real threats," says Phillip Bond, chief executive of the **Information Technology Association of America,** a lobbying group. "We want government to deal with this in a smart way, and we're concerned they might do it wrong."

The worry is that the Pentagon might enact policies forcing tech suppliers to break off pieces of their global supply chains, making it difficult for American companies to deliver the most advanced products to the Pentagon at affordable prices. These days, computer builders, chipmakers, software publishers, and tech-service outfits all tap inexpensive programming talent in foreign countries.

A government effort to fence out offshore suppliers, they fear, could bring a return to the days when too much of the stuff the Pentagon bought was custom-made—a practice made infamous by the government's much-publicized procurement of $600 toilet seats and other absurdly priced items in the early 1980s.

It's not clear yet if the tech industry's fears wil realized. William Schnei Jr., chairman of the Defe Science Board (but not a task force member), say he's confident that the recommendations won't be draconian—or over-reaching. "We're concer with the use of high-enc mission-critical softwar the process with which i gets written," Schneide *BusinessWeek.*

There are no easy solutions, since pieces o software created offsho are embedded througho computing equipment a software packages sold U.S. companies. Besides making sure the Pentag highly networked tech gear is secure goes beyo the issue of offshore programming. After all, Americans can be hacke and spies, too. Says Pau Kaminsky, another Defe Science Board member: "With networks, often i the inside threat that ge you."

–Steve Hamm and Dawn Kopecki

QUESTION OF THE WEEK

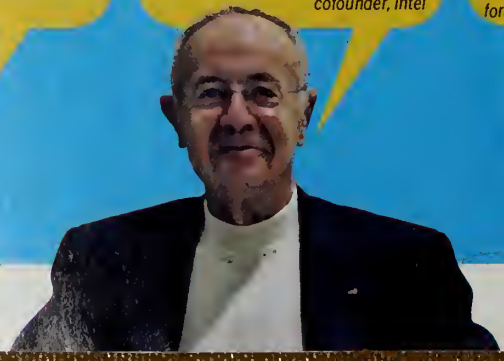
What would a Democratically controlled Congress mean for business, the economy, or your industry?

– Cliff Edwards and Dawn Kopecki

"Monetary policy and the long-run fiscal outlook—they'd be unchanged. The big economic effect would be in sectors with a great relationship with the White House now—oil, defense contractors, pharma." *Justin Wolfers, asst. professor, business and public policy, the Wharton School*

"Whoever wins, the new Congress has to tackle policies on intellectual property, health care, and immigration, an issue that's tearing us apart because it's unresolved. And vocational education, which is abysmal in this country." *Andy Grove, cofounder, Intel*

"Are changes in Washington coming? Probably. But it's important for both parties remember that Americ who suffer from illness don't sign in at the hospital as Republicans Democrats." *Billy Ta president and CEO, Pharmaceu Research & Manufacturers of Amer former Congressman (R.-La.)*



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MEET THE ELEMENT OF CHANGE. A world that includes the Human Element, along with hydrogen, oxygen and the other elements, is a very different world indeed. Suddenly, chemistry is put to work solving human problems. Bonds are formed between aspirations and commitments. And the energy released from reactions fuels a boundless spirit that will make the planet a safer, cleaner, more comfortable place for generations to come. A world that welcomes change is about to meet the element of change: the Human Element.

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"Unfortunately, many managers today [look to] Machiavelli's *The Prince*."

–P.K. Shukla
Orange, Calif.

SpecialReport Managing

Karma Capitalism

WELCOMING BUSINESS ADVICE FROM THE *BHAGAVAD GITA*

I READ WITH DELIGHT about the business world's acceptance of *The Bhagavad Gita* as another source of ancient wisdom ("Karma capitalism," Special Report, Oct. 30). But your readers shouldn't stop there! Study the provocative ideas of the ancient Greek philosopher Heraclitus, whom I consider the world's first creativity teacher. His style is designed to whack us out of our habitual thought patterns so that we can look at what we're doing in a fresh way.

–Roger von Oech
Atherton, Calif.

CERTAIN VERSES IN the *Bhagavad* are both profound and practical for implementing Six Sigma, which Motorola Inc. pioneered in the late 1970s to reduce defects and make companies globally competitive. Note Sri Krishna's counsel: "You have the right to karma, but not to the results of that karma!" This can be fully incorporated in the definition of the outcomes of work processes as desired in Six Sigma.

–Pradeep B. Deshpande
Louisville, Ky.

UNFORTUNATELY, MANY manager
day base their careers and business m
on another literary work not mention
your article: Machiavelli's *The Prince*

–P.K. Sl
Orange,

ONLINE EYEBALL-MEASURING IS MORE EXACT THAN YOU THINK

"WEB NUMBERS: What's real?"
Tech, Oct. 23) discusses a recu
theme, asserting that third-party o
audience metrics are somehow in
rate because they do not match a co
ny's internal server logs.

Third-party estimates are very sp
in what they measure, and they do it
sistently across all players. The rules
are the same for everyone. The auto
assumption that a company's int
server log data "must be" 100% corr
very often unfounded. In the vast m
ity of the cases we investigate, the
Score Networks Inc. numbers prove
sensible and correct. Internal data
overcount audiences for a variety o
sons, such as counting cookies inste
people, and often include page view
requested or seen by end users.

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that online audience measurement is a "crapshoot," we categorically reject the statement as ludicrous. The fact is that the Internet has more precise third-party measurement than practically any other established media, including television, radio, magazines, billboards, etc. It features sample sizes that are orders of magnitude higher than offline measurement systems. The data collection methodology is much less intrusive and far more reliable than paper diaries, readership surveys, or electronic people meters. It is also very cost-effective since clients pay a small fraction of what offline media outlets pay for much less robust, detailed measurement.

ComScore's data are used by more than 600 clients, including industry giants such as AOL, Google, MSN, and Yahoo! These types of companies have ample opportunities to examine and use our data. Fortunately for us, they are voting with their checkbooks. Their ranks grew more than 30% in the last year alone, which would not have occurred if online audience measurement was a crapshoot.

We understand the pressure some companies feel to report higher numbers because it is a reflection of a site's popularity, competitive strength, or a manager's personal performance. For some companies it can be a matter of survival. This is why unbiased third-party services like ours are needed. We work hard to stay abreast of the ever-changing Internet landscape, and we measure all players fairly and consistently. Our job is to do our best at fairly reporting online audiences, unmotivated by any biased interest in claiming larger audiences based on potentially flawed internal data. If there is a crapshoot, it's companies bragging about internal data that are inconsistently computed and typically inflated.

–Gregory Dale
Chief Technology Officer
comScore Networks Inc.
Chicago

THE MYTH OF THE DISINTERESTED MEDICAL RESEARCHER

"MEDICINE IN CONFLICT" (Special Report, Oct. 23) completely fails to recognize that many of the lifesaving devices patients rely on have made their way to the clinic because of physician entrepreneurs like Dr. Martin B. Leon. The superiority of the U.S. medical drug and device industry is significantly driven b economic rewards researchers receiv their inventions and accumulated kn edge. Crimping physician entrepren as many academic and governmen reaucracies propose, would imping the development of new products reduce even more the shrinking fina incentive for smart young individua pursue a career in medicine.

As for drug companies influer physician behavior by buying lu es and giving gifts, I'll stop ac ing drug-company dinners when UnitedHealth, or Aetna decide want to start funding continuing m cal education.

–James C. Hamilton, MD,
Washi

YOUR ARTICLE IMPLIES that it is al a negative if someone has an intere the outcome of the subject of a p Wrong. Most people are ethical, an ther, many good contributions to sc would go unnoticed if only disinter people wrote for journals. A disinter person would not have the fire i belly to get the job done.

How would you go about ge

> [Using] the number of years to break even as the metric for the economic value of an MBA...[is] misleading
>
> *–William Christie*
> *Upper Darby, Pa.*

neone to do the work of writing an ar-
e that has to be rigorous enough to go
ough a peer-review process for free?
–C. Norman Winningstad
Newport, Ore.

N'T UNDERESTIMATE THE VALUE BUSINESS 'WAR STORIES'

RUGGLED WITH the implication in
to the head of the class" ("The Best
chools," Cover Story, Oct. 23) that
cutives teaching in MBA programs
limited to telling "war stories." After
-year career that includes positions
division manager for a Fortune 500 company, a partnership in a successful contracting business, and years of volunteer consulting to small businesses and charitable organizations, I certainly have a "war story" for every situation.

However, I work very hard to organize and present current theory, and yes, like Robert D. Rogers, I was surprised by the prep work that is necessary. The advantage I have over my academic brethren is that I can augment theoretical discussions with real-life examples of success and failure that I have personally experienced. My students report that this is the most valuable and enjoyable part of the learning experience.
–Jack Stiegler, Adjunct Professor
School of Management, City University
Snohomish, Wash.

A BETTER WAY TO MEASURE R.O.B. —RETURN ON B-SCHOOL

I FOUND IT IRONIC that "The high price of admission" ("The Best B-Schools," Cover Story, Oct. 23) used the number of years to break even as the metric for the economic value of an MBA. As an undergraduate business student at Temple University's Fox School of Business, I found this to be misleading. Besides ignoring the time value of money, this measure completely disregards the higher cash flows an MBA grad earns beyond the payback date. When evaluating whether to choose a top-tier school, the prospective student should consider taking the net present value of this investment, found in every Finance 101 textbook.
–William Christie
Upper Darby, Pa.

EARTH TO *BUSINESSWEEK*: SUITS AREN'T JUST A GUY THING

I WAS INTERESTED to read your article on selecting a good suit for your body

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type ("How to be well-suited," Executive Life, Oct. 23). As a sales executive in the Boston area, suits are part of my uniform, and I was eager to find tips on cuts, fabrics, and patterns.

Imagine my disappointment when I realized that the article was targeted to men only. Can I expect to find a similar article for your female readers in the near future? Until then I'm left wondering: At 5 feet 2 inches, should I be following the guidelines for "The Short Guy," or do completely different rules apply to women?

–Sandy Carielle
Somerville, Mass.

CORRECTIONS & CLARIFICATIONS

"The organic myth" (Cover Story, Oct. 16) "To see where tech is headed, watch TI" (The Corporation, Nov. 6) incorrectly stated that Seiko Epson Corp. uses TI chips in its projectors. Seiko Epson uses a competing microdisplay technology called 3LCD.

The table comparing basic points from *The Art of War* and the *Bhagavad Gita* in "Karma capitalism" (Special Report, Oct. 30) should have credited the sources of the translations. Several quotations came from the *Bhagavad Gita and Effective Leadership* by Pujan Roka and *The Art of War*, translated by Lionel Giles.

IN THE LONG RUN, PRESCHOOL PAYS OFF FOR THE ECONOMY

KUDOS TO CHRISTOPHER FARRELL FOR for his excellent article, "Going beyond Head Start" (Social Issues, Oct. 23) on the payoff from preschool programs. Farrell rightly points out the findings from the much-peer-reviewed Perry Preschool Project Study, while noting its relatively small sample size.

Readers may be interested to know that other studies confirm many of Perry Preschool's findings, including high rates of economic returns. Among these are the Chicago Child Parent Center, Abecedarian Project, Milwaukee Project, Early Environmental Enrichment Program, and Infant Health & Development Program studies. It is also notable that the gain in workforce productivity that will result from providing today's children with high-quality preschool educations makes this one of the few proven pro-growth policies and will help keep the Social Security account balance in p tive territory in the future when the b boomers retire.

–W. Steven Ba
Dire
National Inst
for Early Education Rese
Princeton,

HOW CLO INVESTORS CAN KEEP FROM GETTING BURNED

"DANGER: EXPLOSIVE LOANS" nance, Oct. 23) accurately descr some "froth" in the loan market, that can be said about credit mar generally at this point in the cr cycle. However, bank loans have uni features that protect in times of st including credit protection from t seniority and security and financial enants that control risk. Add their default rate, high recovery rate, volatility, and lack of interest rate and you have an attractive asset clas which investors have confidence.

But your article was more about alleged dangers of collateralized obligations (CLOs), one of the type funds that invest in loans. The ar even calls them "just as worrisome

*Based on seven nights at Starwood, Hilton InterContinental Hotels Group, and Hyatt full-service hotels of similar quality and points earned on dc

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ge funds. However, few investment icles offer investors the protections CLOs, such as monitoring by the or rating agencies, sales limited to edited investors, transparency, col- ral tests, and structural protections. itionally, CLO managers do not just loans and package them into a l for a fee. Nor are managers short- ging fundamental credit analysis, ated in the article.

f course, investors must still con- their due diligence and invest with agers who have long-standing track rds and a disciplined portfolio man- nent style, and who take the time to structure CLOs to fit the manager's stment style. Chosen correctly, col- alized loan obligations can be an llent investment opportunity.

–Matthew A. Miller, Chairman
teralized Loan Obligation Committee
Loan Syndications & Trading Assn.
New York

READY FOR ANOTHER CTION NIGHTMARE

N OHIO POLL WORKER, I attended ing last week, and I can tell you that of the staff are woefully unprepared to work on Nov. 7 ("Beware the high-tech ballot," Tech & You, Oct. 23).

In Ohio a measure called HB3 was passed in the statehouse. Because this law requires stricter identification standards, it is believed that a huge number of paper provisional ballots will be needed on election day. Since the provisional ballots cost a dollar each, every precinct will receive only 100 provisional ballots. When poll workers run out of those, we're supposed to switch to the "electronic machine provisional system." But no one was properly trained in how to switch systems—even the trainer seemed confused. I expect a long, exhausting day on Nov. 7 for my precinct and state.

–Jeff Robertson
Yellow Springs, Ohio

THE WRONG WAY TO SAVE ENDANGERED SPECIES

KUDOS TO THE Bush Administration for pressuring India and China to stop trafficking in tiger parts. ("And on his farm he had a tiger," UpFront, Oct. 16). The novelist Paul Theroux has predicted the extinction of whales, dolphins, gorillas, rhinos, elephants, and tigers by the year 2100 and the near-extinction of giraffes, grizzly bears, pandas, and wolves by that year as well. Entrusting the Convention on International Trade in Endangered Species with their survival on factory farms we use to immobilize and slaughter domesticated animals like pigs, chickens, and cows would be like letting wolves guard the henhouse.

–Shalesh Kumbhat
Chicago

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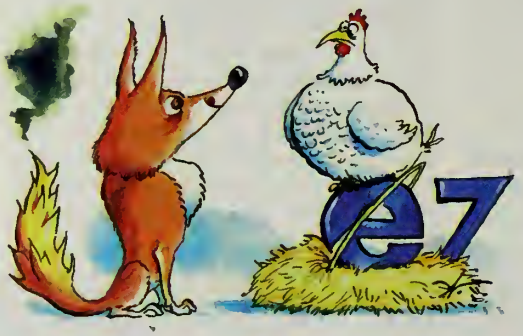
Tech&You

BY STEPHEN H. WILDSTROM

Explorer's Long-Awaited Updat

The browser is the most important piece of software on most people's computers, so it's odd that Microsoft let Internet Explorer go five years without a redesign. Internet Explorer 7 is finally here, and it's a welcome addition. But IE is no longer the unchallenged king of Web browsing, an the new version must contend with a spiffed-up Mozilla Firefox.

The biggest change in IE is the elimination of gaping security vulnerabilities that have dogged this software for a long time. This change is invisible to users. But IE also gets a brand new look and feel, one that provides an important preview of what is coming in January with Windows Vista and, especially, Microsoft Office 2007.



Microsoft is downloading the new IE automatically through Windows Update, though corporations that choose to can block the change on their systems. When you take a close look at the browser, you'll notice that the row of menu choices at the top of the window, a feature of nearly every Windows program for more than 15 years, is gone; no more File, Edit, or other familiar items.

On the whole, this is an improvement. Nearly all the menu choices have been duplicated by icons, and Microsoft decided it was time to clean up the screen. But the more experienced a user you are, the more disorienting you may find the new arrangement. For example, the Save As command, always a part of the File menu, now appears when you click on a New Page icon. You can turn the menus back on, but I recommend learning to navigate without them because in Office 2007, they're gone for good. Once you learn your way around, this is a cleaner, simpler design.

I'M LESS WOWED by some of the new features in IE 7, including fraud alerts, automatic Web site updates (RSS feeds), and tabbed browsing, which keeps a collection of Web pages within a single window and allows you to flip among them just by clicking a tab. These are all nice additions, but they're pathetically overdue, having long been available on other browsers such as Firefox or Opera.

Using Microsoft's version of tabbed browsing, it's simple to select a collection of pages and have them open automatically when you start the browser. A "quick tabs" button shows thumbnails of all your active tabs in a single window.

Whenever you visit a site that offers automatic updates, an orange icon in the toolbar lights up, and you can subscribe to the feed by clicking it. You vie the contents by selecting the from your Favorites list.

The changes in Firefox 2.0 are much less dramatic, most because little was required. L the new IE, it has added an a fraud feature that gives you a color-coded warning when yo visit a page suspected of stea data or downloading spywar Its best new feature is a Word like spell checker that works whenever you are typing in a Web page. If you misspell a w a red squiggle appears under and right-clicking on the wo gives you suggested correctio and other options. With the growing use of blogs and oth content-creation software in browsers, this is a major bles to the typing-challenged.

Most of IE 7's new features are already available on Firefox

At one point, the security of Internet Explorer were so that I urged readers not to us Microsoft has done a lot of repair work, and it will do eve more in the version of IE 7 that is part of Windows Vista. at this point, security isn't much of a factor in your choic But I have come to prefer Firefox for its speed and simpli And on the Mac, where the standard Safari browser is hopelessly inadequate for Web sites where users create content, Firefox is by far the best choice.

Thanks to the pressure Firefox has put on Microsoft, browser competition is back. As a result, two products th are very good right now are destined to get even better.

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You'd be surprised at the frivolous things people spend their money on. Taxes, for example.

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MediaCentric
BY JON FINE

Media's New Masters

It's now a matter of when, not if, private-equity players will begin owning large chunk of the consumer media world. Thus, regardless of who ends controlling Tribune Co. and Clear Channel Communications—to cite just two recent headlines—it's worth considering, without rant or cant, what th will mean to media companies and properties.

Let's first **ABANDON THE FANTASY** of the rich local owner content to let profits slide because owning the local paper gratifies one's ego and public spirit. These types won't always be the buyers. And they're not immune to market pressures. Ask Brian Tierney, who led the local group that bought the *Philadelphia Inquirer*. Flushed with the joy of the deal, he told employees: "This is going to be the best news organization in America. You don't have to worry about the corporate thing." Last month he warned staffers that ugly revenue trends "will prevent us from meeting our bank obligations" without layoffs and other cost-cutting moves.

So say **HELLO TO A NEW MATH**, and the transition to what one successful private-equity-backed executive calls the "comforting and brutal calculus" of such financing: "There is equity. There is debt. There is cash flow. There is interest. There is growth. There is value. That's the world." For decades, major media companies have hewed to a softer accountability, even if they're publicly held: If the CEO can dance—not for nothing did Wall Street call Mel Karmazin a master salesman when he ran CBS—he can buy a few quarters' grace from investor wrath. (As in: "We're not posting massive losses, we're investing aggressively for the future.") A shift to a "hard" accountability won't be easy. A soft-edged ecosystem allowed generations of lower-tier employees to make decent middle-class salaries—in some cases, much better than middle-class salaries. That world has been shrinking. It will shrink faster.

On a slightly cheerier note, expect an even quicker **SPRINT TO DIGITAL.** The calculus is brutal, but it liberates companies from both quarterly expectations and traditional thinking. One media executive who's mulling joining a private-equity play puts it this way. He goes to the Established Media Company and asks for, say, $2 million to build a robust digital strategy—and is told he'll get a fraction of it. He tells Potential Private-Equity Backer the same thing and is told fine—and, by the way, can you make me more money faster if I double it? The sharks of private eq swim remorselessly toward the payo The one undercolonized frontier for media is online. (Most major newsp companies, and NBC Universal, are still years away from getting 10% to revenues from online.) Developmen dollars and management attention shift accordingly.

And **HELLO FOCUS, GOODBYE OLD W** The old-style conglomerate, be it Kr Ridder or Time Warner, consists of properties bolted together more or l haphazardly. Their run of dominati media will end. Also ceasing: what might call the "Wizard of Oz" model of media management practiced by News Corp.'s Ru Murdoch or Viacom's Sumne Redstone. In their place will come tightly focused compan One example: GateHouse Me a newly public small-market newspaper company, whose stock rose 20% on its first day trading. Individual propertie will also be recast. A private-equity-owned (as opposed to a David Geffen-owned) *Los Angeles Times* may end up covering just Southern Califor which readers who enjoy its farther-flung correspondents won't welcome. A private-equity-owned Tribune will jetti notions that there are synergies to be wrung from its Chi TV, radio, and newspaper operations, and perhaps the en notion that it's good for a company to own several kinds media. Ironists alert: It may take the purely payout-seeki approach of private equity to break up the conglomerate, which—remember?—was once the ne plus ultra of greed media ownership. ■

Private equity ushers in a brutal accountability. Get used to it

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/ JAMES C. COOPER

Housing's Tailspin Isn't Pulling Down Consumers

heir buying power and spending are accelerating this quarter

U.S. ECONOMY Economic forecasters all face the same problem: hey try to tell us where we're going based on data that tell us where e've been. Such is the case with the report showing third-quarter onomic growth at a puny 1.6% annual rate. So is the economy's orest quarterly performance in three and a half years a harbinger of kness to come or a relic of the past few months? Vhere economists stand on that issue—and they are ply divided—depends almost exclusively on how y see the role of the housing slump. The pessimists k at the Oct. 27 report on real gross domestic product note that housing construction alone subtracted 1.1 centage points from overall growth, housing's biggest g in 25 years. Aha, they say, the hit from housing is nsifying and will only get worse.

Ione of this sways the optimists. They look at other ors, especially consumer spending, business outlays new equipment and buildings, and exports. They note all three of these demand categories grew faster in third quarter than in the second. In particular, they nt to household spending, which finished the quarter strong note. All this suggests increased momentum ling into the final quarter, despite the likelihood of her sizable hit from housing.

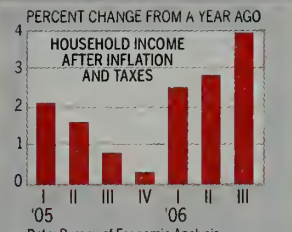
Vho's right? So far, after nearly a year of nothing but news from housing, the optimists still make the nger case. The pessimists have yet to show evidence the weakness in housing is spreading to other rs of the economy, particularly consumer spending. ing by the latest data, consumers seem oblivious to ging housing starts, the drop in home demand, and r home prices. In fact, consumer spending appears accelerating this quarter, not slowing down.

SEHOLD PURCHASING POWER is clearly gaining d, thanks to moderate job growth, faster gains in ly pay, and a much smaller bite from energy costs. In mber real—or inflation-adjusted—aftertax income ed 0.8% from August. Excluding data distortions d by Hurricane Katrina in 2005 and the big Microsoft dividend payout in 2004, it was the largest monthly ase in more than three years. So far this year, real aftertax me has risen at a 3.3% annual rate, enough to support olid 3.5% advance seen in real consumer spending. en more spending power is on the way. In the nt quarter the 27% drop in gasoline prices since August means overall inflation will rise little, if at r the quarter. So on the whole, every dollar earned by consumers can go to purchasing goods and services, with almost none going to higher prices.

For example, households shelled out 5.6% more dollars on items in the third quarter than in the second, measured at an annual rate. But prices rose at a 2.5% rate, leaving the real gain at 3.1%. It is this real gain that contributes to growth in real GDP. If consumers were to lift their spending by the same dollar amount this quarter as they did last quarter, and prices were to stay steady, then real outlays would increase by 5.6%. That's not a forecast, but the example illustrates the possibility of a very strong contribution to overall economic growth this quarter from consumer spending.

How all this is affecting the mood of households in October depends on which survey you follow. The Conference Board's index of consumer confidence dipped last month, as consumers retained some concern about the job market. The index stood at 105.4, close to the average for all of 2006. The University of Michigan index of consumer sentiment for October jumped to the highest level since July, 2005. However, the most important gauge of how consumers feel is how much they are spending, and that measure looks just fine.

PURCHASING POWER PICKS UP SPEED



Data: Bureau of Economic Analysis, Global Insight Inc.

THE FORTUNATE TIMING of the drop in pump prices and the stock market rally has helped to mitigate the secondary impact on consumer spending from weaker housing activity and home prices. One fear has been a sharp cutback in outlays for home-related goods, but there is still no sign of that. Real consumer spending on furniture and household equipment this year has grown at an annual rate of 10.8% through the third quarter, little changed from the 11% pace during all of 2005.

Even more important, signs continue to point to a

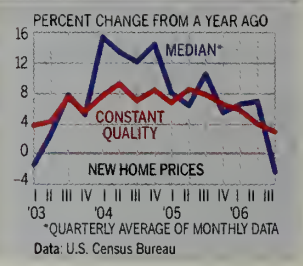
moderation in the housing downturn itself. Sales of new homes rose for the second month in a row in September, and the ratio of inventories to sales also declined for the second consecutive month. Plus, 30-year fixed mortgage rates have dropped from 6.86% in mid-June to 6.24% at the end of October, and applications to buy homes have stabilized. Lower mortgage rates, the rising purchasing power of incomes, and softer home prices are combining to lift affordability and put a floor under demand.

THE OTHER BIG CONCERN is the fallout on spending from softer home prices, which some fear will erode household finances. However, the 8% surge in stock prices since the end of July has more than offset any loss in household net worth due to weaker home prices. Last quarter's gain in the broad Wilshire 5000 stock index suggests that household balance sheets scored a big advance in financial assets on the order of $800 billion.

There is also a basic question of just how much home prices are weakening. The popular median measures for existing and new homes show September price declines of 2.2% and a huge 9.7%, respectively, from a year ago. However, both of these gauges can be influenced by shifts in the composition of homes being sold. For example, if fewer high-priced homes are sold relative to lower-priced ones, the median price will decline, even if prices of all the homes in the sample are unchanged. Given the growing gridlock between buyers and sellers of high-end homes, that factor may be at work now. Just the opposite may have occurred in 2004, when booming sales of million-dollar homes caused the median price to soar.

Two quarterly price indexes—one for existing home compiled by the Office of Federal Housing Enterprise Oversight (OFHEO) and one for new homes put togeth by the U.S. Census Bureau—attempt to adjust for some these problems. They show prices decelerating, but no nearly as rapidly as the median measures.

WHICH MEASURE IS CLOSER TO THE TRUTH?



Data: U.S. Census Bureau

The price index from Census, which covers new homes, attempts t adjust for the very flaw that may have caused the sharp September drop. The gauge is a constant-quality index that accounts for thing like square footage and the number of bedroo and baths. This measu was up 2.9% from a year ago, not down as the quarterl average of the median data show (chart).

The OFHEO index, which standardizes existing-hon prices by looking at a fixed group of houses over time, was up 10.1% in the second quarter vs. a year ago. Tha rate is sure to drop in the third quarter, when the data reported on Dec. 1, but the pace should stay positive.

One thing is for certain: Soft home prices and decli ing construction activity will continue to hold back the economy in the months ahead. But the data still show plenty of other forces helping to push it forward. ■

EMPLOYEE BENEFITS

A Bigger Burden, But a Bigger Paycheck

EMPLOYERS ARE getting the upper hand on the surging costs of benefits, particularly those of health insurance. But while companies are making many employees pay a bigger share of health-care premiums, the tighter labor market is also leading Corporate America to give back some of those savings in the form of fatter paychecks.

Third-quarter figures from the employment cost index (ECI) showed benefit costs rising at a 3.3% pace from a year ago. That's the slowest gain in at least five years. Supplemental data from the U.S. Bureau of Labor Statistics on health insurance costs show a 4.9% rise from a year ago, down from 5.2% in the previous quarter. Costs in 2006 are on track to grow at the smallest rate since the late 1990s. Looking ahead, human resource companies Hewitt Associates and Towers Perrin are forecasting further deceleration in employer health-care costs for 2007.

AS BENEFIT COSTS SLOW, WAGES PICK UP

Data: Bureau of Labor Statistics, Global Insight Inc.

The slowdown in benefits costs means "employers have been willing to allow more compensation gains to filter into take-home pay," according to Morgan Stanley chief U.S. economist Richard Berner in an Oct. 30 research note. The ECI data, which adjusts for changes in the composition of the labor force, showed that wages and salaries grew by 3.2% from a year ago, the biggest rise in more than four years. Thos figures validate other pay indicatc such as average hourly earnings, which stood at a multiyear high i September.

Even though employees are likely to shoulder a larger share o their own health-care costs, Hewi Associates estimates those extra expenses will take up about 16% of the expected gains in employee salaries next year, which are projected to grow by 3.7%.

Meanwhile, overall inflation is also slowing down as gasoline, oi and natural gas prices have fallen summer highs. The combination improving income gains and slow inflation will translate into higher inflation-adjusted wages for work and provide plenty of support for consumer spending. ■

–By James Mehring in New

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News you need to know

EDITED BY HARRY MAURER

The SEC Gets Busy

By and large, the SEC hasn't exactly been overworked lately. The number of cases brought has been shrinking since the 2001 **Enron** collapse, falling nearly 10%, to 575, in fiscal 2006 from the year before. **Chairman Christopher Cox** (photo) has pledged to root out more wrongdoers in 2007, and a flurry of activity suggests he's already making good. On Oct. 30 the agency charged nine former **Delphi** executives with fraud, accusing them of manipulating company finances while the auto parts maker sank into insolvency. The same day, Swiss bank **UBS** said it was cooperating in an SEC probe of Treasury securities price manipulation. And some two dozen mutual funds suspected of accepting kickbacks from vendors are under the microscope.

But now the investigators are being investigated. On Oct. 26, **Senate Finance Chairman Chuck Grassley** (R-Iowa) said the **Government Accountability Office** would review claims that SEC officials shielded **Morgan Stanley CEO John Mack,** a campaign donor to **President George W. Bush,** from an insider trading probe of hedge fund **Pequot.** The GAO is targeting units led by SEC enforcement chief **Linda Thomsen** and its head of compliance, **Lori Richards.**

See "Keeping SarbOx is crucial," page 134

Growth Takes a Breather The hammering of housing slowed the U.S. economy to a crawl in the third quarter, but consumers are feeling O.K.—a relief for Republicans trying to hang onto their seats in Congress. The economy grew at an annual rate of just 1.6% in the July-September quarter thanks to the homebuilding slowdown and a jump in imports. Yet the **Conference Board** said on Oct. 31 that its in of consumer confidence barely faltered in October. Ma it's those gasoline prices, averaging just $2.22 a gallon $3 this past summer.

ONLINE *See "The economy's housing proble www.businessweek.com/go/*

Drugstore Romance Did the specter of **Wal-Mart** s these two giants into each other's arms? On Nov. 1 dr store chain **CVS** and pharmacy benefits manager **Caremar** said they would marry in a deal worth more than $20 lion. While other suitors for Caremark may step forward alliance with CVS would give the two more heft in the f for market share. Wal-Mart in September began rolling a plan to sell generic drugs at $4 for a 30-day supply.

ONLINE *See "CVS-Caremark: A drug industry behem www.businessweek.com/go/*

Blockbuster Blues **Pfizer** executives must be feeling pain. Data released on Oct 31 show that torcetrapib, company's drug meant to boost levels of so-called g cholesterol, also hikes blood pressure more than expec That's a major no-no for a heart drug, and experts sa clouds chances of winning **FDA** approval. Pfizer is spen close to $1 billion on torcetrapib in hopes that it will be next **Lipitor,** its $12 billion cholesterol buster that could generic competition by 2010.

Chevron Wins One Jubilation in the oil patch: The **rior Dept.** has thrown in the towel on efforts to get Chev to fork over additional natural gas royalties. The decis disclosed by *The New York Times* on Oct. 31, could s precedent that saves other oil and gas companies hund of millions. Interior said a ruling in a separate case m its pursuit of Chevron pointless. Critics accused the B Administration of going easy. Meanwhile, on Oct. 26, **E Mobil** rang up another $10 billion-plus quarterly profit.

Hedge Fund Watch Uh-oh, another hedge fund clo up shop—but not for the familiar reason of scary tra losses. **Archeus** said on Oct. 30 that it had come unc because an outside bookkeeper it hired had trouble k ing track of its $3 billion in assets. "Protracted del issuing audited reports, Archeus said, led investors to more than $2.3 billion. The players might have had r patience had returns been less lackluster.

Black and White and Unread Newspapers have l sliding for a while, but this drop is a doozy. Data fo six months ended Sept. 30, released on Oct. 30, show worst industrywide circulation plunge in at least 15 y The top 50 papers posted an aggregate daily loss of 3 according to Prudential Equity Group. Hardest hit an the top 10 papers: **Tribune's** *Los Angeles Times,* down 8%. only gainers in the top 10 were New York City's war tabloids, the *Post* and the *Daily News,* which were up and 1%, respectively.

hat Did BP Know? Extending BP's long string of image-smirching events, a federal safety panel said the oil giant ew of "widespread safety problems" before a March, 2005, st at its Texas City refinery killed 15 and injured 180. The **emical Safety & Hazard Investigation Board** released findings on t. 30 concluding that the accident resulted from "a perfect rm where aging infrastructure, overzealous cost-cutting, dequate design, and risk blindness all converged." BP has nowledged that the accident was preventable but denied t budgetary decisions were an immediate cause.

althier Chicken? What a coincidence. After years of isting it couldn't be done, **Yum! Brands** said on Oct. 30 t its **KFC** chain will stop using trans fatty oils to deep-fry chicken. This came just as New York City's health board vened a hearing on whether to make the city the first to trans fats in restaurants. By next May, KFC's 5,500 U.S. s will switch their vats over to a soybean oil without fatty ls, which heighten the risk of heart disease.

ONLINE *See "KFC joins the trans-fat fight," www.businessweek.com/go/tbw*

at's a Big IPO Global investors continue to stam- e into China bank stocks. **Industrial & Commercial Bank of a** launched a nearly $22 billion IPO in Hong Kong and nghai on Oct. 27, the biggest share sale in history. De- e the dodgy record of mainland banks in steering clear ud loans, the offering was heavily oversubscribed and t up 15% during its first day of trading. With China's nomy sizzling, investors think big banks are ideal proxy s for the hypergrowth story.

ee "Supercrooks or sitting ducks?," page 50, and "ICBC's IPO: Reckless spending in China?" www.businessweek.com/go/tbw

Conviction of the Week

oks like Halloween brought a trick for **Walter Forbes.** e former **Cendant** chairman was found guilty on Oct. 31 one count of conspiracy and two of false reporting in nection with the accounting scandal that erupted at company almost a decade ago. An attorney for the 6-year-old Forbes told reporters he'll appeal. The ver- t came after juries in two previous ls couldn't come to a meeting of nds, and stems from activities at bes's **CUC International.** That com- y merged with **HFS,** led at the time founder **Henry Silverman,** in 1997 to m Cendant. When the accounting nanigans came to light just a few nths later, Cendant's market capi- zation collapsed by $14 billion in e day. The company never fully recovered from the ndal and was broken into four outfits earlier this year. erman, who testified in this latest trial but not in the vious two, declined to comment. But a spokesman for dant, now called **Avis Budget Group,** says the company very happy that at last justice has been served."

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STOCKS

DOW 12,000: WHOOP-DE-DO

The market's best-known benchmark keeps rising, but investors are underwhelmed. They might want to take another look

BY ROBEN FARZAD

AT LONG LAST, THE Dow Jones industrial average has breached 12,000. The market's six-year ordeal, spanning the tech crash, corporate scandals, and Wall Street double-talk, is over. You can once again mention stocks at cocktail parties and even open up your 401(k) statements. Come on, feel the noise!

O.K., maybe not.

The blue-chip benchmark has indeed surpassed the old record of 11,723 touched in January, 2000. In fact, the Dow is posting new closing highs with regularity—four days in a row, at one point in October. But if the old record was noteworthy for the way it reflected a national zeitgeist, this one is notable for its sense of anticlimax. Last time, even Carmela Soprano was picking stocks. This time, people barely think about them. "CNBC may be making a lot of Dow 12,000," says Strategas Research Partners chief investment strategist Jason D. Trennert. "But the average investor is not."

That, ironically, might be the better news.

It's not difficult to see why investors are underwhelmed. The Dow is at a record, but that's thanks largely to its antiquated method of price weighting, which gives high-priced shares more clout in the overall average than low-priced ones. For example, IBM, a $92 stock, has nearly triple the weighting of $35 General Electric Co., a more diversified company worth $220 billion more than Big Blue.

BEHIND THE EARNINGS

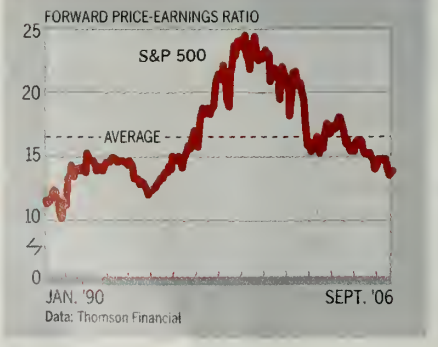
THERE JUST ISN'T MUCH joy in celebrating an index in which only 10 of 30 components are near a record. Credit Exxon Mobil and United Technologies for the Dow's recent strength. But those stocks have made a much smaller impact on another blue-chip gauge, the Standard & Poor's 100-stock index, which is down 24% from its record largely because it's weighted by market cap. In fact, 15 of the 20 most widely held stocks in customer accounts at Merrill Lynch & Co., are their all-time highs, and not by a l The average decline is 48%.

The view doesn't look much b from on high. The bigger Standar Poor's 500-stock index, which serve the benchmark for most money n agers, would have to rally 12% to re its record. And the NASDAQ would to more than double. These num aren't adjusted for inflation; doin would put even the record-setting below its 2000 peak.

Yet many of the reasons why record itself is meaningless suggest stocks might actually be at the s rather than at the end, of something No one can predict the future, of co But for all the hype over the re records, the U.S. market is unquest ably a lot cheaper now than it was a time of the Dow's last fateful peak.

What has historically driven the s market is valuation—that is, the rel amount investors are willing to pay slice of a company's earnings. Profit booming, but investors have been st Despite 13 consecutive quarters of ble-digit earnings growth, the S&P has seen its forward price-to-earn multiple slip to where it was at the st 1996 (chart). That's less than both it and 20-year averages. The profit s should continue: Eight of the 10 S&P

CHEAPEST IN YEARS



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sectors saw earnings expectations rise in October. "Stocks are still way behind earnings," says Trennert, "and the multiples keep coming down. There's just not a whole lot of investor enthusiasm."

The biggest stocks are cheapest of all. Citigroup notes that just as the Dow was getting over the 12,000 hump, the largest 25 stocks in the S&P 500 were trading near 20-year-low valuations relative to the broader market. Yet even that won't convince Ramin Kohanoff, an owner of Los Angeles gas stations and car washes who got burned in 2000 and 2001, to get back in. "It messed me up," he says. "I don't play with the stock market anymore. Dow 12,000? I don't care."

Such caution is common these days. Despite an environment of record earnings and stock buybacks, only one sector has seen its earnings multiple rise in the past three years—utilities. "How exciting," deadpans Michael G. Thompson, director of research at Thomson Financial, of an industry known for glacial growth and reliable dividends. "Twelve thousand is a nice round number, but the valuations are nothing to brag about."

While U.S. stocks are indeed rising, it's more of an upward drift than a surge. Investors have been most aggressive overseas. In September, three-quarters of the $12 billion earmarked to equity mutual funds was directed to global and international investments. Says Oak Associates Ltd. chief investment strategist Edward Yardeni: "Investors remain uninterested in the U.S. stocks that made them money in the 1990s and lost it for them in the early 2000s." It's hard to attract investors to U.S. shares when emerging market economies are thriving anew and even sleepy France and Germany are offering better returns.

The good news for the Yanks is that the gap is narrowing. Emerging market stocks have trounced U.S. stocks throughout the decade—but this year, emerging markets have outperformed the U.S. by only five percentage points. And since May, the U.S. is winning.

The competition inside the U.S. is getting easier, too. Housing and commodities are tanking, suggesting that a tipping point toward U.S. shares may be nigh. "What has been working will not work anymore," says UBS strategist Thomas M. Doerflinger, who studies investor attitudes. "People will appreciate that they can do much better in the stock market than in other asset classes."

That could happen in the typical U.S. household. Doerflinger notes that as households saw their direct investments in corporate stocks fall from 20% of their overall worth in 1999 to 9% in 2006, the real estate chunk rose from 22% to 32%. Today's mix is roughly the same as it was in 1990. But the tables are turning. New home prices plunged 9.7% from September, 2005, to September, 2006, whereas the S&P 500 gained 9.5%. With home prices no longer rising, the sector isn't likely to attract new speculators. Whereas a stock must fall to zero to wipe out an investor, a house need only fall a smidge to wipe out the equity of a buyer betting with a 3% downpayment mortgage.

As the housing market began to fall, interest rates remained buoyant. Investors' knee-jerk reaction has been to park money in cash, not stocks. Trennert notes that aside from the crash-induced rush to cash between 2000 and 2002, money-market fund holdings as a percentage of the total U.S. equity market are the highest they've been since 1992.

Yet the allure of cash is questionable. Short-term rates have risen from around 1% to more than 5%. But even a 5% yield on a one-year certificate o posit is effectively cut in ha taxes and inflation. Stock average, have returned a 10.5% annually over the run. Cash would become less attractive if the Federa serve were to cut interest r an event some market wat are predicting for 2007.

The upshot: Stocks seer pealing merely by proce elimination. With comm ties, housing, and cash al ing their luster, money sh increasingly move elsew All the noise surrounding 12,000 could prompt the l of inflows needed to brin market higher, particula international stocks paus catch their breath. "There' of pent-up demand," Trennert. "You have a lot c ly room when people lo their statements, like wha U.S. offers, and their bu begets more buying."

"Investors want to see performance," adds Yar "They tend to get in a ye two into it." He has his ey January and February, investors usually focus nancial planning and decide where to put yea bonus money.

Of course, much of to lukewarm sentiment for ties is a vestige of the deep heartbre vestors felt the last time around, stocks were all-consuming and NA 5,000 was just another stop on the r New Economy nirvana. Says Citi strategist Tobias M. Levkovich: "Wh ally excited investors was the sen boundless upside—that it could on up." But as the go-go NASDAQ fell points in a blaze of scandal and ear restatements, many investors resol hold anything but stocks. Today bulls' sober case is one of valuation reversion to historical patterns—h the stuff of an overactive imaginatic

Which suits optimists just fine. less people care," says Levkovich, better it is for the market." ■

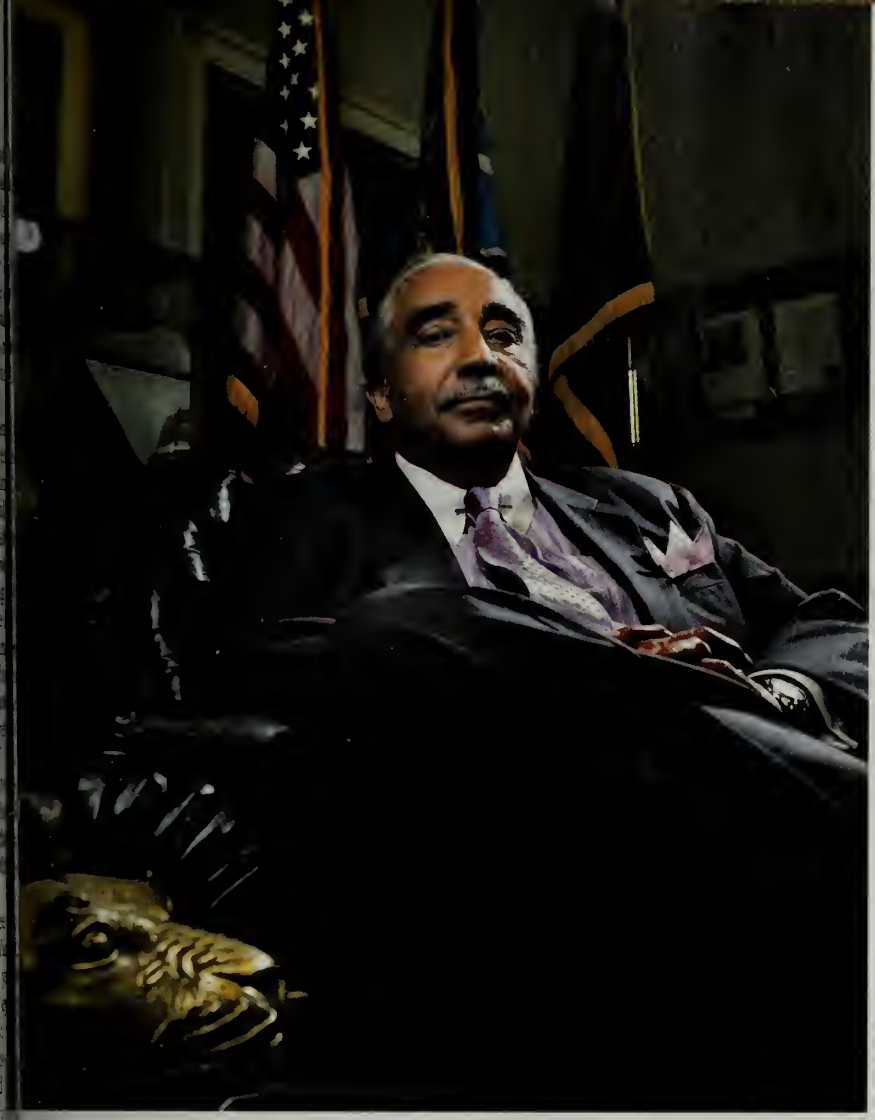
Room for Improvement

Fifteen of the 20 most widely held shares in Merrill Lynch customer accounts are far off their highs

COMPANY	RECENT PRICE*	RECORD HIGH
General Electric	34.90	60.00
Pfizer	26.54	49.00
Microsoft	28.81	59.56
Exxon Mobil	71.06	71.62
Johnson & Johnson	67.18	69.10
Cisco Systems	24.10	80.06
Verizon	36.97	69.50
Intel	21.02	74.88
AT&T	33.76	59.19
Citigroup	50.09	54.76
Lucent	2.41	63.22
Procter & Gamble	63.04	63.81
IBM	91.80	137.88
Chevron	66.98	67.85
Bank of America	53.58	54.82
Comcast (A)	39.85	53.13
JPMorgan Chase	46.93	65.67
Walt Disney	31.73	43.63
Time Warner	19.77	83.00
Merck	45.67	89.80

*As of Nov. 1 close
Data: Merrill Lynch & Co., Bloomberg Financial Markets

BusinessWeek weekend For more on the market and investing in stocks, watch our weekly TV show, *BusinessWeek Weekend*. Check your loc listings, or go to businessweekweekend. to see video clips or type in your Zip Co find when and where it airs in your area.



"WHEELER-DEALER" Rangel is for freer trade and less partisanship

HE MIDTERM

WHO'S AFRAID OF CHARLIE RANGEL?

Business worries about the Dems gaining control of the House. Maybe it needn't fret

BY RICHARD S. DUNHAM

PRESIDENT LYNDON B. Johnson liked to joke that "we haven't done anything for business this week—but it is only Monday morning." In his day, corporate interests often a Democrats as allies.

oday, accurately or not, many executiv equate Democrats with higher taxes, e latory excess, and lawsuits run amok. With most pundits forecasting major Democratic gains in the Nov. 7 midterm elections, business is bracing for the worst.

It may not have to.

On issues ranging from Sarbanes-Oxley rules to immigration to retirement security, business may find some unlikely allies in Democrats such as Charles B. Rangel of New York, Barney Frank of Massachusetts, and John D. Dingell of Michigan. "Should they be in charge, they're going to want to create a coalition that enables them to continue being in charge," says Jay Timmons, a senior vice-president at the National Association of Manufacturers and a longtime aide to Senator George F. Allen (R-Va.).

Top Dems are already planning post-election sessions with business leaders, including former Clinton Administration Treasury Secretary and Citigroup Chairman Robert E. Rubin, to discuss the party's economic agenda. House Minority Leader Nancy Pelosi (D-Calif.) says she intends to consult regularly with such CEOs as Cisco Systems Inc.'s John T. Chambers, a Republican who has backed President George W. Bush. Pelosi has said she supports cutting the budget or closing tax loopholes to offset new spending. "Democrats understand the importance of a growing and vibrant economy," says Pelosi, the Democrats' Speaker-in-Waiting. To be successful, "you have to govern from the middle."

CONSENSUS

WITH THE ELECTION still days away, it's premature for Democrats to celebrate or schedule hearings. But polling shows them leading in 240 districts, 22 more than the number needed to seize the House. On the Senate side, they need to capture six Republican seats to gain control; late October polls showed them ahead in five states and tied in another. Of course, even a more conciliatory approach probably won't deter Democrats from convening oversight hearings to target certain industries with close ties to the Bush White House—particularly energy, pharmaceuticals, insurance, and defense.

Still, as business contemplates the probability of a Democratic House in 2007, corporate interests are discovering that some liberals are more open to consensus building than might be expected. "In the end, Democrats will realize that to accomplish anything, they'll have to do something in combination with the business community," says Matt Bennett, vice-president of Third Way, a moderate Democratic strategy group.

Business has started to reach out to Representative Frank, the sharp-minded, sharp-tongued liberal who is in line to be chairman of the House Financial Services Committee. Frank is best known as a progressive on social issues, but Republican colleagues and business lobbyists who have worked with him on financial matters say he is willing to work across party lines. "Barney Frank is fair, he's smart, and he's focused," says former Representative Steve Bartlett (R-Tex.), now CEO of the Fi-

nancial Services Roundtable. "That's the kind of leadership we need."

Frank is widely expected to encourage some curbs on the 2002 Sarbanes-Oxley law, which imposed new governance rules on companies in response to a series of corporate scandals. While the White House and some Republicans favor lifting some of the mandates, they have been waiting for the retirement of Financial Services Committee Chairman Michael G. Oxley (R-Ohio), who is leaving Congress at the end of this year, before changing the law he co-authored with outgoing Senator Paul S. Sarbanes (D-Md.).

Democrats want to keep the transparency provisions of the new law but ease small business reporting requirements that have made it harder for entrepreneurs to raise capital, says Frank. They also want to reduce what Senator Charles E. Schumer (D-N.Y.) calls "compliance minutiae" that businesses consider burdensome and a drag on innovation. Frank says he wants to puncture "the myth that if you're a liberal, you're an anti-capitalist."

Companies, too, are confident that in response to the ill-fated 2006 Dubai Ports World deal, Frank will side with them against draconian curbs on foreign investment in the U.S. "He has been very thoughtful in stopping some of the reforms that would chill foreign investment," says former Bush Administration official Robert S. Nichols, now president and COO of the Financial Services Forum, an organization comprised of the CEOs of the 20 largest U.S. financial institutions.

Another issue where Democrats and business are on the same page is immigration. Companies were stymied in their attempts to push sweeping immigration legislation this year because House Republicans refused to consider business-backed plans to create a guest worker program and a path to legalization for undocumented immigrants, saying they did not want to reward those who broke the law. House Republicans opted instead for stepped-up border enforcement, despite support for a comprehensive package from Bush, the Senate, and House Democrats. Says GOP lobbyist and Bush adviser Charles R. Black Jr.: "If you did have a Democratic House, which I'm not ready to concede, it would be closer to the Senate and the Republican President than the current Republican House."

Representative Rangel, a close friend of organized labor and a tireless advocate of antipoverty programs, is nonetheless a leading Democratic advocate of trade liberalization. Stung by GOP criticism of his

BORDER CROSSING Democrats want a compromise with Republicans

votes against recent Bush trade initiatives because they did not include labor and environmental provisions, Rangel wants to extend trade preferences in Africa, the Caribbean, and the Andean nations.

With Presidential fast-track trade negotiating authority up for reauthorization in 2007, Rangel says he hopes to work with U.S. Trade Representative Susan Schwab to end the partisanship over trade. "So many people want to wor get things done," says Rangel, the wo be chairman of the Ways & Means C mittee. He's also seeking business' i on strengthening copyright protec and other intellectual-property iss "Rangel is an old bull, wheeler-dealer islator," says R. Bruce Josten, execu vice-president at the U.S. Chambe Commerce. "He's going to want to things to the President's desk."

Other industries may score victori the potentially new Washington. P promises to champion research and velopment, including extending the r expired R&D tax credit. Among the ners would be biotech, electro communications, and chemical conce

Pelosi and other Democratic lea have other motives to reach out to b ness. Over the 12 years of Republican the Democratic share of contribut from business political action commit has slipped from 51% to 34%, accordi the nonpartisan Center for Respor Politics. Pelosi knows that a growth a da blessed, at least in part, by some b ness leaders could help ease the party's age as antibusiness.

The political realities of divided gov ment could also tame the liberalisr some of the new Democratic comm bosses. President Bush could use his to block any economic legislation he poses. On tax issues, Democrats say party would not move to raise corpo taxes, but a Democratic House woul unlikely to agree with President Bu proposal to permanently repeal the e tax on the top one-half of 1% of estate

Even if many Democrats want to n to the left, their liberalism will be l ened by up to 30 pro-business fresh Democrats, says Bruce Reed, forme viser to President Clinton and now p dent of the moderate Democratic Lea ship Council. "Democrats are going t more centrist because [moderates] the balance of power."

–With Lorraine Woellert in Washin

Open for Business

Business may benefit in key areas if Democrats gain control of Capitol Hill:

NANCY PELOSI

1 Sarbanes-Oxley. Democratic leaders have said they would work to smooth over the more onerous provisions of the corporate governance law.

2 Immigration. Democrats in both chambers are more in line with President Bush and business than many GOP lawmakers who opposed guest worker programs or a citizenship track for illegals.

3 Trade. Charles Rangel of New York, who would become the top Democrat on trade if his party wins the House, plans to push for extended trade deals with African, Andean, and Caribbean nations.

4 Foreign Deals. Despite widespread public opposition to the Dubai Ports World deal, Democratic leaders share companies' worries about draconian measures to tighten up the process by which deals between American and foreign companies are reviewed for national security concerns.

5 Fiscal Discipline and Balanced Budget. This cuts both ways since one of the Democrats' means of restoring fiscal discipline entails not reauthorizing some of Bush's tax cuts.

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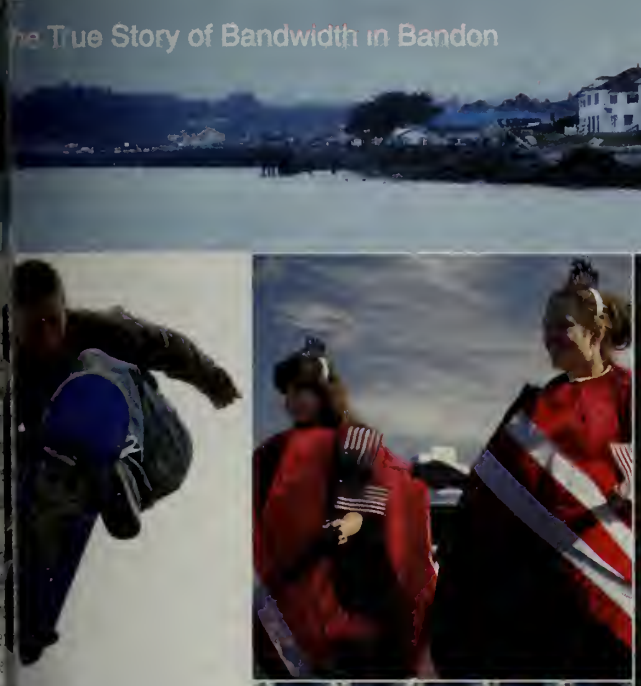

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STOCKS

A CLOSER LOOK AT TRADES BY TOP BRASS

Some execs may be abusing an SEC "safe harbor" rule on insider stock sales

BY JANE SASSEEN

LATE LAST YEAR, AFTER a seven-month surge nearly tripled shares in Midway Games Inc., CEO David F. Zucker apparently decided it was time to lighten his load. So on Dec. 8 he filed notice with the Securities & Exchange Commission that he'd set up an automatic trading plan to sell some of his shares in the Chicago-based company, best known for its popular *Mortal Kombat* video game.

And unload Zucker did—with a vengeance. On Dec. 19 he sold 50,000 shares for $1.1 million. Over the next three weeks, Zucker sold another 50,000 shares every trading day, breaking only for Christmas and New Year's. By Jan. 6, Zucker had sold 650,000 shares for $12.9 million.

ZUCKER The Midway Games CEO sold 650,000 shares in three weeks

Zucker's timing couldn't have been better. Less than a week after he set up his trading program, Midway's board approved a plan to take charges of $20 million and cut the workforce by 11%. The news meant Midway's losses for 2005 would be significantly higher than its projected $95 million. After it was made public on Dec. 16, Midway's stock began a precipitous slide. From 23.26 on Dec. 15, it fell 57%, to 9.91, by late February.

A lucky coincidence? Just good timing? Or something more? It's the sort of insider sale that's drawing increasing attention because it came after Zucker created what's known as a 10b5-1 plan. These trading programs, named for the SEC rule in 2000 that authorized them, were designed to create a way for executives to sell shares without facing insider-trading charges.

To get that protection, however, executives must meet several conditions: They must create a plan at a time when they don't know of significant nonpublic information, and they must fix the dates or the price of trades in advance.

But in the face of evidence that insiders who set up such plans appear to be earning outsize gains, these trades are coming under closer scrutiny. A recent study by Stanford University Graduate School of Business assistant professor Alan D. Jagolinzer questions whether executives are in fact able to tap inside knowledge to set up and time the sales they make in the plans.

As reported in *BusinessWeek* on Oct. 26, Jagolinzer analyzed data on nearly 100,000 trades made by 2,995 insiders who had set up 10b5-1 plans at 1,016 companies from 2003 to 2005. While phasizing that the results are prelimir Jagolinzer found that insiders, on aver were beating the market by 5.6%. Insi appear to be particularly prescient in ing before stock slides, selling twice a ten ahead of bad news as good news.

Indeed, some executives appear t using 10b5-1 plans in a way that counter to original expectations. Wher rule was written, the assumption was execs would set the plans to trade sh on a regularly scheduled basis over m months—selling, say, 10,000 shares or first of the month over the course of a

Instead, some executives are crea plans that quickly sell off big chunk stock. "The rule was set up to give ex tives a safe harbo they could make tine sales without ing to worry abou sider trading e month," says Sta Sporkin, a for head of the SEC's enforcement "Now it appears it has been turned something it wasn't designed to do."

Executives who trade in such a ma do run a higher risk of losing the legal tection afforded by the rule. Take trades made by Midway's Zucker, wh up his plan just a week before the De restructuring and charges to earn were announced. The news started a ket rout, and with earnings in flux, Zu may have been vulnerable to insider-t ing allegations had he sold shares wit a plan. Shareholders also feared that tinuing problems might spur Sumne Redstone, whose purchases had fuele stock's rise from 8 to 23 since the sprin reduce his stake. Zucker did not respo requests for comment.

Zucker wasn't the only Midway who decided to sell shares last Decem Three others set up 10b5-1 plans and stock then—including two who also ated them in the before the restructu was announced.

Plans filed by ar sider close to a big nouncement raise tions. "The dates gest he was setting plan up in anticip of really using the i mation, of getting for trades," say source close to the "If that were the ca don't know if he w get protection."

JUST IN TIME

Data: Bloomberg Financial Markets, company filings

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DRAFT The New York newbie landed a big one

ADVERTISING

MAD AVE'S MAN OF THE HOUR

Howard Draft won over Wal-Mart with a potent mix of data-mining and creativity

BY DAVID KILEY

HOWARD DRAFT BLEW into Manhattan from the Windy City three months ago, but Madison Avenue is just beginning to feel the blast. Following the merger of his direct-marketing shop, Draft Worldwide, with Foote Cone & Belding, one of the oldest names in the ad business, Draft christened the company with a new first name: his own. Then, on Oct. 15, the agency now known as DraftFCB shocked the ad world by winning Wal-Mart Stores Inc.'s $563 million account, the biggest and most watched piece of ad business up for grabs this year.

Draft is an unexpected figure to be shaking up New York's ad world. As big public holding companies bought up agencies over the past 25 years, the iconoclasts whose images inspired Hollywood— David Ogilvy, Jay Chiat, and Jerry Della Femina, to name a few—have died out or retired. Today, Madison Avenue is ruled primarily by staid B-school grads. Though Draft has spent his career in direct marketing, the geek squad of the ad business, he's a fun-loving, creative thinker whose supersized personality is a throwback to that earlier era. He loves partying, fast cars, poking his industry in the eye, and laughing at himself.

That joie de vivre, combined with Draft's entrepreneurial mindset, helped win over Wal-Mart and allowed him to leapfrog Steven Blamer, who came to FCB last year from white-shoe ad shop Grey Global Group, for the top job. "Howard had a more imaginative vision for what the agency could be," says Michael I. Roth, chief executive of the Interpublic Group of Companies, DraftFCB's parent.

Wal-Mart executives agreed. Draft's team bowled the retailer over with a strategy for mining its vast data bank of customer information and melding it with behavioral data anal that Draft has refined for other clients Verizon Communications and the Postal Service. Wal-Mart especially li the fact that Draft's proposal would al it to change ads or featured merchan and micro-target customers in each l market almost daily. "We have tr formed marketing from a predomina national approach to one that's store store and customer-by-customer," Julie Roehm, senior vice-president marketing communications at Wal-M

Still, hiring DraftFCB just a months after its merger is a leap of f for Wal-Mart, whose sluggish sl price is testing the patience of Street. The retailer is trying to overl its image and reignite earnings by tracting higher-income buyers with products. DraftFCB parent IPG has b in a financial quagmire for almost years because of previous bad acco ing practices and a series of boto mergers that drove away clients.

Audacity and strong persuasive s helped Draft land Wal-Mart. The CEO i ready known for pushing a controve idea that agencies open their books to slashing clients and set performance gets. He once told an audience of cre directors at the Cannes Lions Internat al Advertising Festival that the prev year's winners "did a lousy job of deli ing results for their clients." During Wal-Mart pitch, he boyishly inv Roehm to drive his Aston Martin. An convinced her, a high-profile client hadn't won yet, to join him at dinner kumquat martinis at Nobu New where he tried to sell consultants on hi sion for the agency. "Roehm's unu presence was the buzz of the dinner," Linda Fidelman of cor tancy ADvice & ADviso

Just what is Draft's sion? He's out to creat idea factory that's streamlined as Wal-M supply chain. Global a cies like FCB have walls between advertis direct marketing, and lic relations, with guarding its own bo line more than the cli brand. Only a few s shops have offered a of services on a single "It's been impossible t this on a global basis, that's what we are d starting in the U.S. Wal-Mart," says Draft

Wal-Mart's Weight

The retailer's ad account is the biggest up for grabs so far this year.

TV SPENDING	FREE-STANDING INSERTS
$430 MILLION	$3 MILLION
NEWSPAPER	**RADIO**
$33 MILLION	$25 MILLION
INTERNET	**OTHER**
$35 MILLION	$37 MILLION

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INDISCRETIONS

HARASSERS IN HIGH PLACES

With legal payouts rising, more managers who cross the line are winding up in rehab

BY MICHELLE CONLIN

SCOTT STACY WAS DRIVing home from work in late September when news of the Mark Foley sex scandal came over the car radio. The details were shocking. Foley had sent sexually charged e-mails and instant messages to former teenage pages, in which he made repeated references to sexual acts and body parts. But to Stacy, the story was all too familiar. He runs what is becoming an increasingly important fixture on the treatment scene for the professional class: a rehab for sexual harassers. "I work with so many people in positions of power," says Stacy, founder of Lawrence (Kan.)-based Acumen Assessments Inc. "When they fall, they fall real hard."

Companies have long packed off their troubled throngs to treatment centers for alcohol and drug addiction. But in recent years more and more have begun sending the serial workplace sex harasser, or "boundary violator," to get help, too. With jury awards for sexual misconduct in the office on the rise, companies figure it's better to spend the thousands of dollars on psychological treatment than to wait for a lawsuit that ultimately could cost millions. What's more, in the age of e-mail—as the Foley scandal demonstrated all too clearly—it's getting easier to prove that improper behavior has taken place. Shipping a managers off to rehab, says Garry Mathiason, a partner with the San Francisco employment law firm Littler Mendelson, "shows the employer took it seriously and did something about it."

In recent years, a half-dozen facilities have made the treatment of sexual harassers a specialty. Nestled in anonymity in such places as Mississippi and Georgia, they feature bucolic-sounding names like Pine Grove and Ridgeview. For his part, Foley checked into Sierra Tucson, a 160-acre spa-like treatment center, where a typical stay can cost up to $65,000. Foley's lawyer issued a statement that the former Republican congressman is being treated for alcoholism. But Sierra Tucson specializes in various maladies, including sexual addiction and compulsivity.

What can managers expect at one of these places? Following a psychosocial assessment, therapists tailor a reco program to deal with the offender's derlying problems. In the case of gra ic language and locker-room joshing, manager may simply need a we worth of assessment and education more serious cases, such as cyberst ing and predatory come-ons, therap work to uncover the original trauma is spurring the behavior. That pro can take several months and inclu both group and individual therapy. tients learn what emotions trigger s things as "boundary drift" and "in propriate channeling of unmet nee Sexual harassers, therapists say, o have damage from childhood. The is to teach them how to cope with th issues.

Sexual Boundaries 2.0

In many workplaces, the definition of harassment has become more nuanced

20 YEARS AGO	TODAY
Sexually explicit remarks	Sexually explicit e-mails, IMs
Lewd one-on-one talk	Raunchy office banter
Inappropriate touching	Inappropriate joking
Violating office romance policies or dating subordinates	Violating company-imposed relationship pacts, aka love contracts

DIGITAL TRACKS

SOMETIMES an accu account differs wildly f the accused's. That pro ed the Professional Ren Center in Lawrence, Ka put a polygrapher on s But as the world bec one giant archive, the stances of he-said, she are fading. The disinhib power of e-mails and v mails are seductive to se harassers, but also men alize the wrong in wri "Men, frankly, are still p dumb about this," says Paul M. Earley, directo adult addiction medi and the impaired pr sionals program Ridgeview Institute Smyrna, Ga. Then agai that data can be usef therapists; companies send rehabs reams o criminating electronic dence scraped off a ha er's hard drive.

Most companies some form of sexual ha ment training these days. And the n ber of charges filed with the Equal ployment Opportunity Commission from 15,549 in 1995 to 12,679 in 2 But with jury awards and settlem headed in the opposite direction, ex expect rehabs to remain in demand. ployees who file complaints often v sue if they feel the manager has cha and made an apology. Of course, re vism does occur. In those cases, the b sliders, just like drug addicts, are sent straight back into treatment. ■

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CARMAKERS

MERCEDES GETS BACK UP TO SPEED

A focus on quality and cost has the luxury maker humming again

BY GAIL EDMONDSON

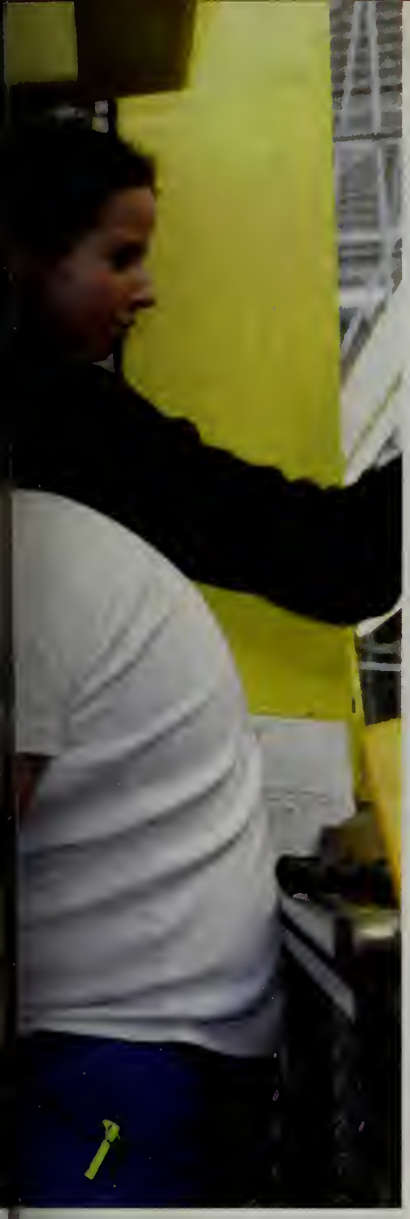
DAIMLERCHRYSLER Chief Executive Dieter Zetsche may be losing sleep over the woes of Daimler's U.S. unit, Chrysler Corp., but he's sure to be breathing easier about once-troubled Mercedes-Benz. On Oct. 25, when Chrysler reported a $1.5 billion loss for the third quarter, Mercedes posted a 127% jump in operating profit, to $1.2 billion. Sales are up 9.3% this year, and analysts expect the turnaround to stick. "The downward spiral," Zetsche says, "has changed direction."

Mercedes' improved fortunes couldn't have come soon enough. The prestigious automaker is finally emerging from the most painful stretch in its 127-year history: a three-year slump in which its once-hallowed reputation for quality and engineering took a beating even as rival BMW surpassed it in global sales. Mercedes' fall in recent years was so precipitous it helped spur the early departure of former CEO Jürgen Schrempp.

The troubles became apparent in 2003 when the world's No.1 luxury brand landed near the bottom of J.D. Power's annual quality survey. Then, in 2004 and 2005, electronics snafus led to widespread recalls, further denting Mercedes' reputation and finances. And as Mercedes dragged its heels modernizing its manufacturing techniques, competitors made huge strides in improving the they build cars. As a result, even to "Mercedes is getting squeezed on sides by very high-quality cars produ at half the price," says Jay Baron, hea manufacturing at the Center for Auto tive Research in Ann Arbor, Mich.

Enter Zetsche as top dog. After r ning Chrysler from 2000 to 2005, took over DaimlerChrysler 14 mor ago. Zetsche quickly set about slash some 9,300 jobs by offering worl buyouts. More important, to shake Mercedes' hidebound culture he kic off a radical restructuring, organizing company around functional element the car—motors, chassis, and electro systems—instead of by model lines.

Other automakers have already g down this path, but for Mercedes the s marks a big departure. Suddenly, mo overlords, once free to design cars fi the wheels up, are required to cho from a common basket of modules components. Mercedes is aiming to



S-CLASS New tests found more than 1,000 errors before cars hit production

e 226 door handle variants to 71, 99 ing systems to 25, and 171 antenna gns to 53. The list goes on and on. with each new model, thousands of rent parts will be shared instead of g engineered from the ground up.

ut Mercedes still has a long way o. Its costs per vehicle are as much 3,800 higher than for comparable vs, says Ferdinand Dudenhöffer, director of the German Center for Automotive Research at the University of Gelsenkirchen. Much of that difference could be made up by standardizing design and manufacturing and sharing more parts, but Mercedes is a good five years behind the likes of BMW and Toyota Motor Corp. in this arena. Zetsche also aims to boost the flexibility of Mercedes' factories, which today build just one model per line. By 2010 that should rise to two per line, making it easier to adjust output to meet demand. Still, rivals now produce up to six models on each line.

MILLIONS OF TEST-DRIVE MILES

FORTUNATELY FOR ZETSCHE, Mercedes already has tackled some of its thorniest problems. To address the electronics debacles, engineers begin testing systems up to a year earlier than in the past, and long before the start of production. Today five research and development labs at Mercedes' Stuttgart headquarters root out many of the problems that have savaged its reputation.

Lab workers put each new model's electronics system through a battery of 10,000 tests that run 24 hours a day and take three weeks to complete. One favorite tactic: Simulate what happens when a driver hits buttons all over the dashboard willy-nilly at the same time. "We try to come up with every strange situation possible," says Dieter Serries, Mercedes' head of development testing. Mercedes used the technique to ferret out more than 1,000 errors in the new S-Class, including one where the blinkers didn't function when there was no air conditioning system in the car. Says Zetsche: "You can find 99% of the glitches before a car ever hits the road."

Even so, engineers are doing more test driving than ever, thanks to a decision to build three times as many prototypes of new designs. That allows engineers to drive a new model 3 million miles before it goes into production.

Manufacturing processes are getting an overhaul, too. At Mercedes' 10,000-worker Sindelfingen plant near Stuttgart, which churns out 1,200 E-Class sedans a day, managers have analyzed each work station to reduce complexity and boost quality. For instance, when laser sensors in the body shop detect minute flaws caused by robots, a computer sends an instant message to the cell phone of the engineer, or *Meister*, in charge. And workers now take 30 minutes from each shift to do maintenance, avoiding breakdowns by reducing wear and tear on machinery. Ergonomic seats on the E-Class line help workers swing in and out of the cars without strain, reducing errors. Photos illustrating a perfectly executed job hang over each work station, replacing confusing written descriptions. And the assembly line is punctuated with "zero-defect gates," where cars can't pass until they are certified flawless.

Since electronics problems peaked in 2002, the number of flaws has dropped 72%, to about one per car. And warranty costs are down by 25% this year. "It's about doing things right 1 million times over," says Mercedes Chief Operating Officer Rainer Schmückle.

Zetsche aims to keep the pressure on, using some of the tactics he deployed at Chrysler to speed change. When a manager gets a report of a problem, it is logged into a database, and the clock starts ticking. If the manager can't figure out how to fix faulty parts or systems within three weeks, the case automatically lands on Zetsche's desk. That seems to be incentive enough. In the four months since he implemented the practice, only one case has ended up there. "Quality was always a given at Mercedes," Zetsche says. "We trusted too long in a given system instead of trying something new." ■

BEST-PRACTICE IDEAS

Retooling Mercedes

How to repair a premier auto brand

WAGE WAR ON DEFECTS

Thousands of stress tests on each model's electronic systems, followed by early production of prototypes, helps catch snafus before production begins.

DITCH THE OLD WAYS

Mercedes' 100-year-old strategy of building each new model from scratch means more cost and complexity. The answer: Share more parts, and design across model lines.

REHAB THE FACTORIES

The company is rethinking each work station and plans to build at least two models per line by 2010. That will help keep plants running at capacity.

ENGAGE THE SUPPLIERS

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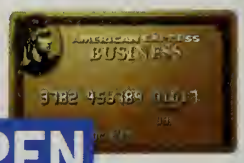

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MOSCOW'S GREEN GIANT

Environmental honcho Oleg Mitvol isn't afraid to make enemies

GADFLY He's taking aim at the biggest foreign investment in Russia

Y ASON BUSH

HE'S FAST BECOMING one of Russia's best-known public figures, and his face is seen regularly on television and in newspapers. Now, Oleg Mitvol is making s internationally as he takes on Rus- biggest foreign investors.

tvol is deputy head of Rosprirod- or, Russia's environmental protec- agency. Although Rosprirodnadzor ong been a government backwater, r Mitvol's lead the agency is waging npaign against the huge Sakhalin and gas project in the Far East. l says Sakhalin Energy Investment 55% owned by Royal Dutch Shell has caused up to $50 billion in onmental damage with its drilling rms and pipeline. "We'll defend a's environment, and we'll de- t openly," Mitvol declares.

e Sakhalin II project is the big- foreign investment in Russia –May 15), but that's not stop- Mitvol from threatening to sue lin Energy for billions of dol- damages. Prosecutors are also igating whether the company ed any laws, which could lead s or prison for its executives. lin Energy acknowledges that roject has faced challenges gues that it is doing its best et Russian demands. Royal Shell CEO Jeroen van der Veer says the company is trying to ensure that the pipeline is "in line with all regulations.... But if we make a mistake, we have to correct that."

Mitvol's eye for publicity is unusual for a Russian official. But he's no ordinary bureaucrat: The 40-year-old Mitvol became a millionaire in the early days of Russian capitalism, before he joined the government. He got his start organizing trips for Western tourists in the late 1980s and early '90s. Then he earned some $20 million through Russia's privatization program and by investing in media, chemical, food processing, and other companies.

In 2004, Mitvol quit business to work at Rosprirodnadzor. It didn't take long for him to make a name as an environmental

BIO

Oleg Mitvol

BORN: Moscow, 1966

EDUCATION: Engineering degree, Institute of Electrical Engineering & Communications, 1988.

BUSINESS: Organized tours for Westerners, 1989-1993. Invested in finance, media, chemicals, and food processing but sold everything by 2003.

GOVERNMENT: Deputy director, Rosprirodnadzor, Russia's environmental protection agency, 2004-present.

Data: *BusinessWeek*

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gadfly. In one campaign, for instance, he targeted the luxury homes of pop stars and politicians that were built on protected land. Rosprirodnadzor "has done a great deal of good," says Ivan Blokov, campaign director for Greenpeace Russia. But some question Mitvol's motives in the Sakhalin effort, saying the Kremlin is using Rosprirodnadzor to pressure Sakhalin Energy to renegotiate its agreement with Moscow. Under the 1994 deal, Russia doesn't make money on Sakhalin II until after Sakhalin Energy recovers its costs, which the company announced last year would double, to $20 billion.

Mitvol denies he's following orders from on high. "No one tells me what to do," he says. Far from encouraging his campaign, he adds, senior officials are trying to put the brakes on it. In an odd twist, police raided Rosprirodnadzor Oct. 18, seizing documents related Sakhalin II. While Mitvol says he's being investigated, it may be no cc cidence that Rosprirodnadzor recer began looking into Russia's own ene giants. Undaunted, Mitvol says he'll ch lenge anyone who breaks the rules—e if that means making enemies of th with connections in high places. ■

SAFE HOUSE? Xu and Xu allegedly stole $485 million

SCAMS

SUPERCROOKS OR SITTING DUCKS?

A Chinese fraud case snags two bankers stateside—who claim they're scapegoats for bank safety

BY RONALD GROVER

XU CHAOFAN WAS A RISing star. After nearly two decades at the Bank of China, Xu had become business development chief at a branch in the southern province of Guangdong. By 2001, he was managing millions of dollars of investments and taking regular trips to Hong Kong to oversee BOC properties such as a 297-room hotel and a $60 million financial center.

Then, two years ago, U.S. federal agents arrested Xu at an Oklahoma strip mall, where he was working as a cook in a Chinese restaurant and his wife was waiting tables. Today, the 41-year-old Xu sits in jail in Las Vegas, accused of one of the biggest bank scams in history. In January, Xu, fellow branch manager Xu Guojun (no relation to Xu Chaofan), and their wives were indicted by the Justice Dept. on charges of stealing at least $485 million through sham transactions with bogus Hong Kong companies, money laundering at Las Vegas casinos, and illegally entering the U.S.

When the case goes before a jury early next year, the verdict may affect China's financial system as much as it does the defendants. As China privatizes big banks such as the Industrial & Commercial Bank of China, which raised $21 billion in October, Beijing is eager to eliminate lingering concerns over fraud that could hurt its ability to attract money from foreigners. Through their attorneys, the four deny the charges, s ing they are be made scapego in Beijing's eff to convince world that China's banks are safe inv ments. "We're not even sure any mo was actually stolen," says Mitchell Po Xu Chaofan's attorney.

The Justice Dept. paints a picture massive fraud. The two men are accu of sending millions of dollars in ille wire transfers to a dozen or so sh companies they controlled. Although Justice Dept. declined to comment, indictment accuses the pair of funnel that money into their personal accou or those of relatives, including, in case, $6.6 million to the girlfriend of Chaofan's brother-in-law. When the f were arrested, government agents rec ered more than $162,000 in cash confiscated a Lexus SUV and three hor in British Columbia. "If they had much money, why would they be wo ing as cooks?" questions Bret Whip Xu Guojun's attorney. "We'll show t this is a political case."

The U.S. government's account of wh all the money went is not clear. But two men, on Bank of China salaries just $4,000 a year, appeared to live high life, according to a deposition by Zhen Dong, another manager at the sa branch who pled guilty to conspiracy is cooperating with prosecutors. The n and their wives made frequent trips fr Hong Kong to Las Vegas, dropping much as $400,000 apiece each time, testified. They even were once flown to gas by a casino on a private jet, Yu said perk reserved for the highest rollers.

In 2001, BOC officials spotted the alle fraud. That's when the feds say Xu and plotted their escape from China, ass ing aliases and securing visas through manager of a textile factory they did b ness with. To get U.S. citizenship, the b says, the men and their wives arran fake divorces and married Chinese-b U.S. citizens—in the coffee shop of the Angeles International Airport. ■

Jeff graduated from MIT and belongs to Mensa®.

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JEFF BEZOS' RISKY BET

Amazon's CEO wants to run your business with the technology behind his Web site. But Wall Street wants him to mind the store.

BY ROBERT D. HOF

IT WAS ONE OF THE WEB'S typical flash frenzies, a gaggle of geeks seeking the new, new thing. At 2 a.m. on Aug. 24, a new venture called Elastic Compute Cloud quietly launched in test mode. Its service: cheap, raw computing power that could be tapped on demand over the Internet just like electricity. In less than five hours, hundreds of programmers, hoping to use the service to power their MySpace and Google wannabes, snapped up all the test slots. One desperate latecomer instant-messaged a $10,000 offer for a slot to a lucky winner, who declined to give it up. "It's really cool," enthuses entrepreneur Luke Matkins, who will run his soon-to-launch music site on the service. The creator of this *très* cool service: Amazon.com Inc.

Yes, Amazon founder and Chief Executive Jeffrey P. Bezos, the onetime Internet poster boy who quickly became a post-dot-com piñata, is back with yet another new idea. Many people continue to wonder if the world's largest online store will ever fulfill its original promise to revolutionize retailing. But now Bezos is plotting another new direction for his 12-year-old company, which he will lay out on Nov. 8 at San Francisco's Web 2.0 Conference, the annual gathering of the digerati crème. Judging from an advance look he gave *BusinessWeek* on one

RICK FRIEDMAN

recent gray day at Amazon's Seattle headquarters, it's so far from Amazon's retail core that you may well wonder if he has finally slipped off the deep end.

Bezos wants Amazon to run your business, at least the messy technical and logistical parts of it, using those same technologies and operations that power his $10 billion online store. In the process, Bezos aims to transform Amazon into a kind of 21st century digital utility (table). It's as if Wal-Mart Stores Inc. had decided to turn itself inside out, offering its industry-leading supply chain and logistics systems to any and all outsiders, even rival retailers. Except Amazon is starting to rent out just about everything it uses to run its own business, from rack space in its 10 million square feet of warehouses worldwide to spare computing capacity on its thousands of servers, data storage on its disk drives, and even some of the millions of lines of software code it has written to coordinate all that.

Another big idea from Jeff Bezos? Go ahead and groan. It's fine with him. Even after all these years spent battling back claims that his company would be "Amazon.toast," he's still bounding up and down stairs two at a time to exhort his band of nerds on to the Next Big Thing. And now, more than ever, he's determined to keep going for the big score, even if people think he's crazy. In fact, Bezos, 42, sounds downright eager to confound a new generation of skeptics. "We're very comfortable being misunderstood," he says, letting loose one of his famously thunderous laughs. "We've had lots of practice."

YOUNG TURKER
California's Cranston plans to use Amazon to create a startup

But if techies are wowed by Bezos' grand plan, it's not likely to win many converts on Wall Street. To many observers, it conjures up the ghost of Amazon past. During the dot-com boom, Bezos spent hundreds of millions of dollars to build distribution centers and computer systems in the promise that they eventually would pay off with outsize returns. That helped set the stage for the world's biggest Web retail operation, with expected sales of $10.5 billion this year.

What it didn't translate into was the consistent profit growth many investors had expected by now. Lately profits have fallen, dragged down by spending on new technology projects and on free-shipping offers that Amazon considers marketing in place of TV ads. Analysts expect full-year net income this year to come in at about $180 million, or half of last year's total. Most worrisome to investors is Amazon's three-year-plus binge on new technologies. So far this year its spending on technology and content, including hiring hundreds of engineers and programmers to produce all these new services and buy more servers to run them, is up 52%, to $485 million. As a result, operating margins, at 4.1% for the past four quarters, now come in at less than Wal-Mart's 5.9%. Even Barnes & Noble Inc., that doughty bricks-and-mortar book chain that many expected to get remaindered by the Web, has higher margins, at 5.4%. "I have yet to see h these investments are producing any profit," gripes Piper J fray & Co. analyst Safa Rashtchy. "They're probably more c distraction than anything else."

All that has investors restless and many analysts throwi up their hands wondering if Bezos is merely flailing arou for an alternative to his retail operation. Eleven of 27 analy who follow the company have underperform or sell ratings the stock—a stunning vote of no confidence. That number sell recommendations is matched among large companies o by Qwest Communications International Inc., according investment consultant StarMine Corp. It's more than even t eight sell opinions on struggling Ford Motor Co.

Neither analysts nor investors think Amazon's busin is in danger of collapse. It's just that they're slowly losi confidence in Bezos' promises. The company's 2007 price-earnings ratio of 54 is much higher than its peers', even th high-flying Google Inc. at 35. But Amazon's stock is down 2 since the start of the year. A 12% one-day jump on Oct. 24 flected slightly better-than-expected third-quarter results, l also investor relief that Bezos plans to slow the growth of n tech spending (chart, page 57).

What's more, at the same time Bezos is thinking thoughts, Amazon's retail business faces new threats. 25% sales growth tracks a little above the pace of ove e-commerce expansion and nearly double its own pace v back in 2001. But other sites are fast becoming prefer first stops on the Web. Google, for one, has replaced re sites such as Amazon as the place where many people st their shopping. And more personalized and social upsta such as News Corp.'s MySpace and YouTube, which Goo is buying, have become the prime places for many people

gather online—and eventually shop. It's a trend Amazon could have trouble catching up to. Says consultant Andreas Weigend, Amazon's chief scientist until 2004: "The world has shifted from e-business to me-business."

With all those problems, some might view Bezos' latest tech toys as an attempt to take their eye off the ball. But spend some time with Bezos, and it becomes clear there may well be a method to his madness. Amazon has spent 12 years and $2 billion perfecting many of the pieces behind its online store. By most accounts, those operations are now among the biggest and most reliable in the world. "All the kinds of things you need to build great Web-scale applications are already in the guts of Amazon," says Bezos. "The only difference is, we're now exposing the guts, making [them] available to others."

And, he hopes, making money. With its Simple Storage Service, or S3, Amazon charges 15¢ per gigabyte per month for businesses to store data and programs on Amazon's vast array of disk drives. It's also charging other merchants about 45¢ a square foot per month for real space in its warehouses. Through its Elastic Compute Cloud service, or EC2, it's renting out computing power, starting at 10¢ an hour for the equivalent of a basic server computer. And it has set up a semi-automated global marketplace for online piecework, such as transcribing snippets of podcasts, called Amazon Mechanical Turk. Amazon takes a 10% commission on those jobs.

Bezos is initially aiming these services at startups and other all companies with a little tech savvy. But it's clear that inesses of all kinds are the ultimate target market. Already, azon has attracted some high-powered customers. Micro- Corp. is using the storage service to help speed software nloads, for instance, and the service is helping Linden Lab dle the crush of software downloads for its fast-growing Second Life online virtual world. Highly anticipated search upstart Powerset Inc. plans to use the Amazon computing service, even though it's still in test mode, to supplement its own computers when it launches in mid-November. And the search engine marketing firm Efficient Frontier uses Mechanical Turk to determine the most effective keywords that drive traffic to Web sites.

By all accounts, Amazon's new businesses bring in a minuscule amount of revenue. Although its direct cost of providing them appears relatively low because the hardware and software are in place, Stifel Nicolaus & Co. analyst Scott W. Devitt notes: "There's not going to be any economic return from any of these projects for the foreseeable future." Bezos himself admits as much. But with several years of heavy spending already, he's making this a priority for the long haul. "We think it's going to be a very meaningful business for us one day," he says. "What we've historically seen is that the seeds we plant can take anywhere from three, five, seven years."

A DARK HORSE IN A HIGH-STAKES RACE

SOONER THAN THAT, those initiatives may provide a boost for Amazon's retail side. For one, they potentially make a profit center out of idle computing capacity needed for that retail operation. Like most computer networks, Amazon's uses as little as 10% of its capacity at any one time just to leave room for occasional spikes. It's the same story in the company's distribution centers. Keeping them humming at higher capacity means they operate more efficiently, besides giving customers a much broader selection of products. And the more stuff Amazon ships, both its own inventory or others', the better deals it can cut with shippers.

But there's much more at stake for Bezos than making a few extra bucks selling services that his online store is already providing for itself. This is nothing less than a bid to lead the next wave of the Internet. A dozen years in the making, the economy that has grown up with the Internet by most ac-

UT OF THE JUNGLE

mazon has quietly launched a flurry of new businesses, many in the past year, that are emingly unrelated to its core retail store. Here's a sampling:

OMPUTING

azon's Simple Storage Service and its stic Compute Cloud offer startups such as oto-sharing site SmugMug a way to store a and run their programs on Amazon's nputers over the Internet.

CROWDSOURCING

Amazon Mechanical Turk is a marketplace for piecework. CastingWords pays "Turkers" to transcribe snippets of podcasts that it then assembles for clients. Amazon takes a 10% commission.

MEDIA

Launched in September, Amazon Unbox is software that lets customers download and play movies and TV shows. Amazon.com is also hosting a show with Bill Maher and buying a movie option on a book.

EARCH

er watching Google quickly become a minant force on the Web, Amazon nched its own search site, A9.com, in 03. But it never caught on, and Amazon ently cut many of its novel features.

DISTRIBUTION

For years, Amazon has run e-commerce operations for the likes of Target and Borders. In September it launched a test of Fulfillment By Amazon. Smaller merchants plug their products into Amazon's distribution system.

WEB MEASUREMENT

Alexa Internet Services provides free Web traffic rankings and other paid services, such as detailed reports on specific sites for 15¢ per 1,000 requests. It is becoming a popular alternative to other measurement services.

counts remains in its infancy. And leadership of that burgeoning economy remains up for grabs.

Google and Microsoft, in particular, are each angling to be the Net's kingpins: Just as Microsoft ruled the PC world (and its profits) with Windows software, so Google and Microsoft want to build what techies call the "platform" for the Web—the powerful layer of basic services on top of which everyone else builds their Web sites. "Amazon's a pretty serious dark horse" in that race, says Internet visionary Tim O'Reilly, CEO of tech publisher O'Reilly Media Inc. "Jeff really understands that if he doesn't become a platform player, he's at the mercy of those who do."

Bezos believes he has identified a unique Amazonian edge: Like no other Internet or computer company today, the e-retailer is in a position to apply the efficiencies of the Net to tangible and corporeal assets like products and people. Bezos envisions embedding the tasks of product distribution and knowledge work right into the flow of more automated business processes such as order taking and payment processing. For instance, a new service called Fulfillment by Amazon lets small and midsize businesses send their inventory to Amazon warehouses. Then when a customer places an order, Amazon gets an automated signal to ship it out—no muss, no fuss, no servers or software or garages full of stuff. "Amazon's in the business of managing complexity," says Amazon director John Doerr of the venture firm Kleiner Perkins Caufield & Byers. "There's no other e-commerce player that does that."

Mundane as these business-focused services may sound, the implications for the economy at large are startling. Google, MySpace, and YouTube cracked open for the masses the means to produce media and the advertising that sustains it, creating tens of billions of dollars in market value and billions more in new revenues. Now, by sharing Amazon's infrastructure on the cheap, Bezos is taking that same idea into the realm of physical goods and human talent, potentially empowering a whole new swath of businesses beyond the Internet itself.

The upshot: While Wall Street yawns, Bezos' pioneering dot-com is actually starting to look almost hip again, at least to the all-important Web 2.0 geek gods who set the Net agenda today. More importantly, some venture capitalists have noticed, and they're encouraging their startups to consider using Amazon services to save money and get to market faster. "Amazon is becoming a very interest company," says Crosslink Capital general part Peter Rip. "They're taking their store in the sky unbundling it."

PHOTO APPS Don and Chris MacAskill's photo-sharing outfit relies on Amazon

In any case, this looks like Bezos' biggest bet si he and his wife, MacKenzie, drove west in 1994 to seek fa and fortune on the Net. Since then he has survived the dot-c boom and bust with his ambitions intact. Now with three s and a daughter recently adopted from China, Bezos still managed to find time to start a rocket company, Blue Ori The venture is building a test facility in West Texas not from his grandfather's ranch, where he once spent summ branding cattle. A longtime space nut, he made a valedicto speech in 1982 at Miami Palmetto Senior High School ab the need to colonize space.

Amazon, however, commands his full attention, especi now that the groundwork is laid for the company's latest tra formation. He began not long after the dot-com bust in 2 with—big surprise—a huge project to modernize Amaz massive collection of data centers and the software runn on them. The result was that Amazon made it much faster easier to add new Web site features. Small, fast-moving gro

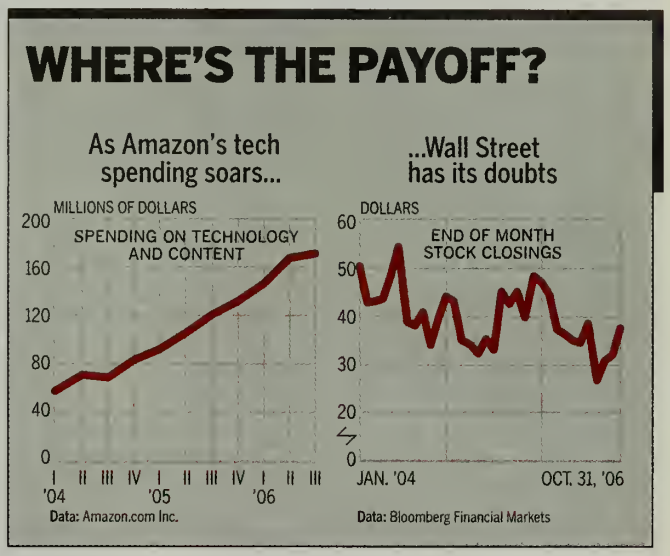
ive to eight Amazon employees now could go hog wild with v ideas, such as customer discussion boards on each prod- page and software to play music and videos on the site. ce then these "two-pizza teams," which Bezos calls them ause each team can be fed with two large pies, have become azon's prime innovation engines. "There's a huge value in small, nimble team approach," says tech consultant and hor John Hagel III. "But you can't do that without this kind omputer architecture."

Text came an epiphany: If the new computer setup al- ed folks inside to be more creative and independent, why open it up to outsiders, too? So in 2002, Amazon began ring outside software and Web site developers access to cted Amazon data such as pricing trends, gradually add- more and more until this year. Now it's basically getting help from more than 200,000 outside Web developers, 50% from a year ago. They're building new services on top Amazon technology, further feeding back into Amazon's retail business. One service, Scanbuy, lets people check azon prices on their cell phones to see if they're better than es in a retail store.

tarting a few months ago, Amazon upped the ante. It be- offering not just data but computing power, storage, and e, all intended to turn even more of its internal operations salable services. One of the most interesting is Amazon hanical Turk. A couple of years ago, Amazon needed to e sure photos it took of thousands of businesses for the ne Yellow Pages on its A9 search site actually matched the t business. Computers are bad at recognizing and sorting ges, but people can do so very quickly. So Amazon set up eb site where it could farm out the sorting to people for a ny or two per photo, clearly more for fun than for big pay. November, it launched the site, naming it after an 18th ury chess-playing machine that actually had a real chess ter hidden inside it.

EW SPARK PLUGS OR STARTUPS

CE ITS DEBUT, the service has attracted thousands of kers" working for dozens of companies. They're doing that Mechanical Turk Director Peter Cohen says "couldn't one at all before," because there was no economical way ther people for these tiny, often ephemeral tasks. Efficient tier has used the service to analyze tens of thousands of ch keywords to see which best attract potential shoppers to



particular Web sites. "There have not been any other services like Mechanical Turk that can do this so efficiently," says software engineer Zachary Mason.

Forget for a moment whether this will eventually turn us all into low-paid piece workers. The important thing is that the service is nurturing startups. CastingWords co-founder Nathan McFarland uses Turkers—who he says are largely the "bored and nothing-on-TV" set who treat the tasks like crossword puzzles—not only to transcribe 10-minute podcast segments but also to assemble them into full transcriptions and to check the quality. Eighteen-year-old Eric Cranston, a onetime Turker living with his parents in Visalia, Calif., plans to use the service for a company he's starting that will retouch photos for Web sites. Essentially, Bezos sees the thousands of people from all over the world working inside Mechanical Turk's online marketplace as a big "human computer."

Amazon's other new services are getting even more serious attention. Last March, Amazon introduced its Simple Storage Service, which offers cheap space on its disk drives for any programmer or business to use to store data. Right away, Amazon approached an online photo-sharing startup called SmugMug Inc. Ironic choice: President and co-founder Chris MacAskill had fiercely battled Amazon in an earlier startup, an online bookstore called Fatbrain, later bought by Barnesand-Noble.com. But his son Don, SmugMug's co-founder and CEO, says that when he heard how easily and cheaply SmugMug

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PLAYBOOK: BEST-PRACTICE IDEAS

SURFING THE AMAZON

Jeff Bezos keeps innovation flowing by following these rules:

MEASURE EVERYTHING.
Decisions are easy when you measure things. Amazon wasn't sure if its TV ads paid off, so it ran a 16-month test in two cities. Result: Bezos nixed the ads and spent the money instead on free-shipping offers.

KEEP PRODUCT DEVELOPMENT TEAMS SMALL.
That forces you to break up projects into doable, measurable chunks. Now most of Amazon's new features and services come from employee teams that can be fed on two large pizzas.

DON'T BE AFRAID OF WEIRD IDEAS.
It breaks you out of either-or thinking. Publishers said Bezos was nuts to let customers post negative product reviews. Now the reviews, which presaged the social Web craze, are one of the most popular features.

OPEN UP TO OUTSIDERS.
They often will do your innovation for you. Starting in 2002, Amazon began letting outside programmers use its pricing and product data. They've created new services that feed back into Amazon's business.

WATCH CUSTOMERS NOT COMPETITORS.
Customer needs change more slowly, requiring less effort than chasing competitors. By constantly lowering prices, Amazon loses near-term revenue but believes customers will spend more later.

could back up its photos on S3, "my eyes got all big." Now, by zapping customers' photos to Amazon to store on its servers, he's avoiding the need to buy more storage devices of his own—and saving $500,000 a year. "Everything we can get Amazon to do, we will get Amazon to do," says Chris MacAskill. "You're going to see all kinds of startups get a much better and faster start" by using Amazon's services.

They already are. Consider Powerset, the secretive search startup backed by A-list angel investors, including PayPal Inc. co-founder Peter Thiel and veteran tech analyst Esther Dyson. Co-founder and CEO Barney Pell harbors ambitions of out-Googling Google with technology that he says would let people use more natural language than terse keywords to do their searches. By analyzing the underlying meaning of search queries and documents on the Web, Powerset aims to produce much more relevant results than the current search king's.

Problem is, Powerset's technology eats computing power like a child munches Halloween candy. The little 22-person company would have to spend more than $1 million on computer hardware, two-thirds of that just to handle occasional spikes in visitor traffic, plus a bunch of people to staff a massive data center and write software to run it. That's when Pell heard about Elastic Compute Cloud. He was sold. Based on tests so far, using the Amazon site for part of the company's computing power could cut its first-year capital costs alone by more than half.

Not least, Amazon is now opening its vast network of more than 20 distribution centers worldwide to all comers. For years it has handled distribution and even Web site operations for the likes of Target Stores Corp. and Borders Group. Recently it has started providing customized handling, packing, and customer service people for upscale retailers and manufacturers such as fashion boutique Bebe. And with Fulfillment By Amazon, it's opening all that up to small and midsize businesses.

With all these initiatives, Amazon empowers new startups, which are hungry to knock off Internet leaders that happen to be...Amazon competitors. Has Bezos thought about how he may be creating an army of allies to fight his rivals? His answer: "Absolutely!"

It's hard to dismiss another possibility, though: Amazon is biting off more than it can chew. Some of the new tech projects have come out with a thud. Compared with Google's, Amazon's A9.com search site never got traction, and its features were recently downsized. The new Amazon Unbox Video downlo ing service struck many early reviewers as clunky and slow

Mostly, it's unclear whether Bezos can escape his and Ar zon's linoleum-floor image. Amazon's mission to be the pl where "customers can find and discover anything they mi want to buy online" doesn't especially mesh with the goa be the prime source of services needed to run an Internet business. By contrast, nearly all of Google's services are clea aimed at building the dominant digital utility. Likewise, I is much better known as a provider not only of technology s vices but also of expertise in automating a wider range of bu ness processes, from inventory management to sales tracki Can Bezos manage a company that simultaneously sells most routine stuff to consumers and the most demand business services to entrepreneurs and corporations?

So it is that Jeff Bezos faces a managerial moment of tru Having saved Amazon from oblivion years ago, he still m prove his latest big bet can help transform the company i something truly enduring. Not only does he make no apolog for such wagers, he revels in them. Every year in his ann letter to shareholders he resurrects his 1997 letter, which re in part: "We will make bold rather than timid investment d sions where we see a sufficient probability of gaining mar leadership advantages."

Today, it's just the same. "We are willing to go down a bu of dark passageways," he says, "and occasionally we something that really works." As always, investing in Be and his company will require faith that there's light at the of his newest tunnel—not just a money pit. ■

Bezos' Big New Bet

Evolution on the Amazon: A slide show traces the company's pat from online bookseller to digital utility.

Bezos speaks: Amazon's CEO tells what's behind his surprising move beyond retail.

Listen in: For Executive Editor John A. Byrne's podcast with Robert Hof, go to www.businessweek.com/podcast.

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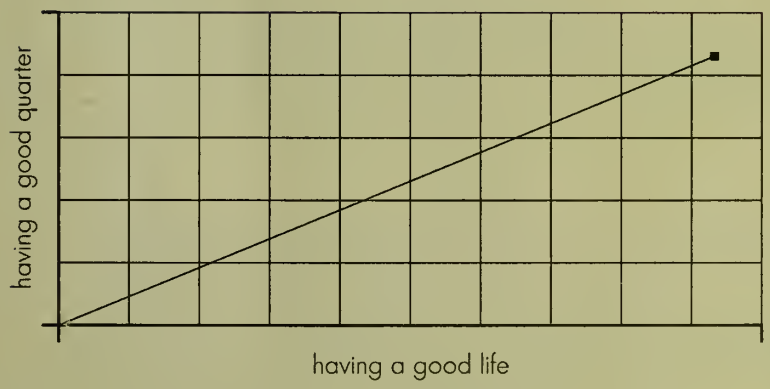
HAVING YOUR CAKE AND EATING IT TOO



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PHOTOGRAPHS BY THOMAS BROENING

HARVESTING GREEN POWER

Farmers are sowing the seeds of an alternative energy future. But how much of the country can we fuel on corn? By Adrienne Carter

ON A STILL OCTOBER AFTERNOON, DAVID Kolsrud is gearing up for the harvest. Today, he'll reap some 30 acres of soybeans on his 500-acre farm in Beaver Creek, Minn. His son, Chris, mans a 12-ton combine, a mechanized harvester that sweeps up whole plants and shoots out a steady stream of beans. This evening, Kolsrud will head off to a grain elevator over the border in South Dakota to deliver 1,100 bushels of them. ¶ As if all this weren't enough to manage, the 58-year-old Kolsrud also runs a burgeoning energy business. Steering his John Deere tractor with one hand and

KOLSRUD HAS INVESTED IN WIND POWER, ETHANOL, AND BIODIESEL

LUVERNE'S ETHANOL PLANT HAS REPAID CO-OP MEMBERS HANDSOMELY

clutching a cell phone in the other, he discusses his stake in a new biodiesel plant in Delaware. Earlier today, Kolsrud played host to a group of Canadian bankers and business developers at a local ethanol plant he co-owns with 220 area farmers. Now there are follow-up discussions, and he's consulting on potential projects in Saskatchewan.

Tomorrow will be just as hectic. Kolsrud has to rise with the sun to make the 105-mile drive northeast to Granite Falls, Minn., for a breakfast meeting with Ron Fagen, a leading builder of biofuel plants and windmills. Before sundown he must squeeze in a few more hours in the field. He's been so busy this year that some of last year's crop is still sitting in silos on his farm. "Corn prices are up, so I guess I'll just have to sell it for more money," he deadpans.

GREEN BiZ

With his mop of white hair and sunburnt cheeks, Kolsrud may be the new face of American agriculture. Alternative energy, once a cause célèbre for bands of tree huggers, has emerged as a pillar of the nation's strategy for energy independence, economic security, and the battle against global warming. Much is riding on efforts like Kolsrud's. For all the talk of green rooftops on Chicago's skyscrapers and wind farms off the coast of Nantucket, there will be no national transition to "green power" without a widespread conversion of our rural farm economy, with its unparalleled abundance of wind, sunlight, and energy-rich crops.

The first wave of energy farming has paid off brilliantly for early adopters like Kolsrud. Based on the value of just his green-energy assets today, he's a millionaire several times over, and the same may be true for hundreds if not thousands of energy farmers across the Midwest. But this transformation of the farm belt raises a host of concerns. To make even a small dent in imports of oil from the Middle East, an increasing portion of food crops will have to be converted to fuel. That could push up the cost of food on the dinner table. And global warming? Critics of America's budding ethanol economy say that if you factor in all the natural resources needed to cultivate corn and transform it into ethanol, the environmental gains are less than meet the eye (page 72).

Pioneers in agricultural biotech say they will soon be able to address so of these worries with better biofue But such breakthroughs require hea investment in research. And given t wild fluctuations in oil prices, which ha fallen by more than 20% in the past se eral months, research funding may r continue at today's heady pace.

"The New Cash Crops"

RIGHT NOW, ON THE rolling prairies Minnesota, the future of energy farmi seems bright. Towering over the fiel of corn and soybeans that stretch to t horizon are majestic wind turbines a colossal industrial plants. Most of th facilities are pumping out ethanol, eco-friendly additive to gasoline; a f are making biodiesel, a clean fuel us to help power trucks and buses. Simi structures already dot the landscape farms across the U.S., from the fertile v leys of California to the orange groves Florida. Texas ranches are now home 2,631 megawatts of wind power, rougl 25% of the country's total wind capac and enough to power more than 650,0 homes. Iowa, America's biggest source ethanol and a major player in wind, n produces so much biofuel and green el

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THE LUVERNE FACILITY BOOSTS CORN DEMAND

FARM **FUTURES** Thanks to farmers' big stake in the green energy rush, rural income and employment are set to surge

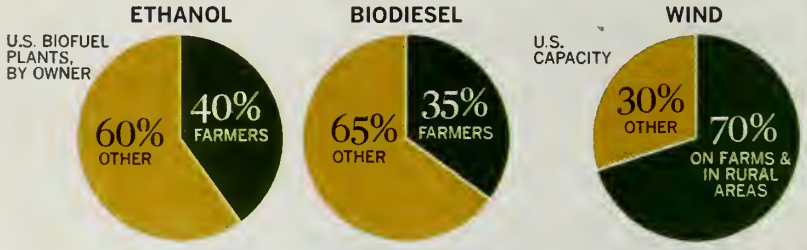
FALLOW America's family farms have struggled for decades

	INCOME PER FARM*	SUBSIDIES	FARM EMPLOYMENT	TOTAL FARMS
1970S	$27,000	6% of farm income	3.9 million	2.95 million
TODAY	$27,000	33% of farm income	3.1 million	2.10 million

*Constant 2006 dollars

Data: U.S. Agriculture Dept., Purdue University

HOME GROWN Farmers have a big slice of green energy markets



Data: Renewable Fuels Assn., American Wind Energy Assn., *BW* estimate

RENEWED Clean energy will add jobs and boost the nation's economy*

	ETHANOL	BIODIESEL		WIND
NEW JOBS	203,879	39,100	NEW JOBS	12,500
ANNUAL BOOST TO US GDP	$46B	$24B	ADDED ANNUAL INCOME*	$100M to $200M

Data: LECG

Data: American Wind Energy Assn.

*By 2015 **For farmers and rural landowners receiving rental payments

tricity that it has gone from a net importer of energy to a key supplier to other states. And Pennsylvania, a big soybean exporter, hopes to have 11 biodiesel plants up and running in the next five years. "Clean energy and biofuels are the new cash crops for farmers," says Howard A. Learner, executuve director of the Environmental Law & Policy Center, an environmental and economic advocacy group.

If Americans start to buy more energy from the Midwest rather than the Middle East, green energy boosters say it will eventually help stabilize energy prices and shrink oil imports. Over the long term, wind power could grow from less than 1% of the U.S. power supply today to 20%. Ethanol and biodiesel, now around 4% of transportation fuels, could go to 20% or more.

Admittedly these are optimistic pr jections. Still, in Washington, lawmake trumpet them as they tout the merits energy independence. But to farme long at the mercy of fickle commod prices and woefully dependent on gc ernment handouts, green mainly mea money. Suppose the U.S. were to redu imports of oil and oil byproducts by 20 and replace that with homegrown bi fuels: In the course of one year—assu ing prices average about $50 per ba rel—farm communities and other biofu players would reap some $50 billion th in the past, would have flowed to forei oil producers.

Wind also brings a payoff. The Ame can Wind Energy Assn. estimates th by 2015 this resource could put an ext $100 million to $200 million in the poc ets of farmers and rural landowners wh rent out land to wind turbines. Gre energy is "the biggest new market we' had for rural America in a long time says Thomas C. Dorr, the Agricultu Dept.'s head of rural development.

Banding Together

FEW PLACES HAVE embraced ener farming as heartily as Kolsrud's home Rock County, Minn., population 9,520. I a community so intimately tied to agric ture that the local radio station updat commodity prices, not stocks. The far supply store, M&M Distributors, is t major chain, not Home Depot. Buffalo a a more common sight than people.

Kolsrud's transformation from trac tional farmer to energy entreprene began in the summer of 1995. After exhausting day weeding his soybeans hand, he realized the years of hard wo and unpredictable pay would break h will, if not his back. Then, as now, t typical farmer's life played out like a s country song. While a 500-acre far like Kolsrud's could pull in more th $135,000 in revenue a year, equipme fuel, and other costs would eat up prac cally all the profit. That dynamic forc many farmers to expand aggressive take on second jobs, or get out altogeth "You could hardly support a family," sa Kolsrud, a fourth-generation farmer wh bought his first 140 acres in 1972, aft returning from military service in Berl during the Vietnam War.

Despite initial skepticism, Kolsr ultimately saw ethanol as an ideal lev to shift his prospects. So he and a han ful of others scraped together $3 m lion from 220 farmers in Minneso South Dakota, and Iowa to build o of the first ethanol plants in the are

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GREEN **BOUNTY** A farm that harvests energy could see income shoot up nearly eight times—and costs could tumble

CORN
Demand for ethanol has boosted prices by 25% in some markets

SOYBEANS
Driven by the growth of biodiesel, soybean prices are up, too

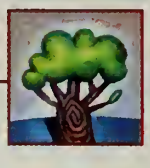
BIOFUEL PRODUCTION
Shares in a local factory pay annual dividends

WINDMILLS
For each turbine on their fields, farmers can get rents of up to $5,000

TODAY'S CROP FARMER	
SALES OF CORN ($2.35 A BUSHEL)	441,100
SALES OF SOYBEANS ($5.50 A BUSHEL)	177,000
US FARM SUBSIDIES	+ 8,900
REVENUES	627,000
COSTS	–600,000
INCOME	**27,000**

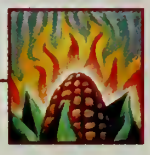
TOMORROW'S ENERGY FARMER	
SALES OF CORN ($3 A BUSHEL)	558,000
SALES OF SOYBEANS ($6.90 A BUSHEL)	220,800
DIVIDEND FROM SHARES IN ETHANOL PLANT	10,000
LAND RENTAL PAYMENTS FROM WIND TURBINES	12,000
INCOME FROM CO_2 SEQUESTERING	100
US FARM SUBSIDIES	+ 3,500
REVENUES	804,000
COSTS	–594,900
INCOME	**209,500**

Data: *BusinessWeek*



TREES
Since trees store CO_2, carbon traders pay a fee for each seedling

SUBSIDIES
As crop prices rise, federal subsidies to farmers will shrink



CORN FURNACE
Burning corn kernels for heat can save $300 a month

SOLAR POWER
Sunshine can cut utility bills by powering a barn, house, or pump

It took two years of arm-twisting, and dealmaking—and they also had to find $18 million in loans and other personal guarantees. "We were a bunch of Forrest Gumps trying to come up with a business model," says Kolsrud.

By 1998, their 12 million gallon factory was up and running. Today, that 100% farmer-owned cooperative, Agri-Energy, has expanded capacity to 21 million gallons, much of it bound for gas stations in New Jersey. The plant is also part of a growing empire. In 2002, some members of the co-op branched into wind energy with Min-Wind, a partnership that operates 11 wind turbines and produces enough electricity for 3,800 homes. Also in their portfolio of green investments are sizable stakes in biodiesel plants and in another dozen or so ethanol factories. In all, Kolsrud and his neighbors have plowed $65 million into green energy projects.

The partners never imagined the rewards they'd reap. The first $1,600 dividend check was such a shock that one farmer actually returned it, thinking the plant had made a mistake. Since the plant opened in Luverne, Minn., eight years ago, a $10,000 stake has earned a total of $54,000 in dividends, and such an investment itself is now worth $55,000.

Demand from the local ethanol plant is also propping up corn prices in the area. Since Rock County is situated far from major corn transport hubs, added freight costs mean that farmers here usually got 40¢ to 50¢ less per bushel than the going rate in Chicago. Thanks to increased demand for corn from Agri-Energy and other nearby ethanol plants, that gap has been cut in half.

It's not unusual for farmers to be millionaires, but typically the money is tied up in land. So extra cash from ethanol and higher corn prices is a blessing, helping people pay off debt on their land or fund their kids' education. Some farmers are splurging on equipment—like the latest tractor with a satellite positioning system and auto-steering. "The biggest complaint now is about the tax bill," jokes Kolsrud, who recently took his family to Aruba and drives a blue Ford Explorer that runs on E85, a blend of 85% ethanol and 15% gas.

Few people in the two-stoplight tow of Luverne have been left untouched l the green-power boom. Locals original griped about the yeasty smell of the emi sions from the plant, but special ge was able to remove the fumes. Now, a b topic of discussion is who in town faile to buy an early stake in the plant ar how badly they regret it. Local tax coffe are also looking healthier: Agri-Ener will pony up around $280,000 in tax to Rock County next year. The semis ar train cars rolling into town to deliver t corn or haul the ethanol to blenders al boost commerce on Main Street.

Still, there are harsh reminders th the fortunes of alternative energy rema tethered to oil prices. At $70 for a barr of oil, it costs $2.60 to make a gallon gasoline, vs. around $1.25 for ethan estimates Paul Ho, a director at Cre Suisse First Boston's energy group. B the gap shrinks as oil prices fall. Mo experts figure that oil would have to du below $30 for months at a stretch befo the economics of ethanol stop maki sense. Yet even with oil trading at ju $60 and ethanol giant Archer Dani Midland reporting bumper profits, W Street is getting skittish. Ethanol stoc like Aventine Renewable Energy Hol ings and VeraSun Energy are 42% a 20% off their initial public offering pri es, respectively, while producer Hawke Energy has delayed its IPO. "People a

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forgetting the high energy prices in the summer. It's crazy," says Jacob Golbitz, research director for consulting firm HighQuest Partners.

It helps that alternative-energy markets are propped up by state and federal mandates to push more ethanol into fuel tanks and more green power onto the grid. The new nationwide renewable fuel standard, for example, calls for 7.5 billion gallons of ethanol production by 2012. Most experts think demand will far outpace those government-set levels, driven in part by state requirements for biofuels and the growing consumer preference for cleaner gas.

MULDER PLANS TO STAY

There are, however, some much darker scenarios, including speculation about a coming ethanol glut. Today, about 106 ethanol plants are operating, with a combined capacity of 5.1 billion gallons. Another 3.5 billion gallons in new capacity is under construction in the U.S., according to the Renewable Fuels Assn. If supply far outstrips demand and prices crash, you could see an archipelago of bankrupt distilleries scattered across the Great Plains. Older, smaller, and less efficient plants, many built by farmers, would be the first to go under, says Ho. Asked about the risk of a price crash, Kolsrud appears unfazed. There's a bit of homespun wisdom he saves for such moments: "You have to accept that some days you're the pigeon, and some days you're the statue."

Wind power follows a somewhat different dynamic. Whether there's a drought or deep snow on the ground, it pays off so reliably these days that farmers call it a second crop. In return for hosting a single turbine, they get $2,000 to $5,000 a year from wind developers. It's not uncommon for a typical family farm to have three or four of those turbines. And if you own the windmills, you can really make a killing. Paul and Alice Neppel originally put up a turbine to offset the $200,000 annual electricity bill on their livestock and crop farm in Dolliver, Iowa. Last year, they made $150,000 selling the energy wholesale back to the local power company. "You wake up in the morning and you're so happy the wind is blowing," says Alice.

Farmers have other ways to play in emerging green markets. One is trapping carbon emissions by planting long-lived trees that lock up carbon dioxide as they grow. Many companies believe that, in the near future, the U.S. government will soon start to impose caps on greenhouse gases, following the lead of governments in Europe and Asia. If that happens, a market will emerge enabling companies to buy and sell credits—essentially rights to emit.

To get a sense of how this will work, U.S. companies have already begun trading credits through a body called the Chicago Climate Exchange (CCX), and paying up in real currency. Farmers can join the CCX to become registered providers of these greenhouse gas emission offsets. Credits equal to the emission of 100 metric tons of carbon were selling recently for about $4.25. It's not hugely profitable right now—a 600-acre farm that sequesters 1,500 tons of carbon dioxide a year would collect little more than $60 in return. But the hope is that those prices will rise sharply if the U.S. goes the way of other countries.

On farms with big populations of chickens, pigs, or cows, even manure c work as an alternative ene source. Using a system kno as an anaerobic digester t transforms manure into me ane, a farmer with a herd small as 300 cattle or 2,0 pigs can produce enough b gas to meet a farm's en heating and electricity nee with some left over to sell b to the market.

New forms of ethanol n also put extra bucks in a fa er's pocket some day. M experts agree that cellul ethanol, made from nonf crops such as switchgrass well as corn stalks and ot biowaste, will be the next driver of gro for the industry. The technology to m this is still a few years off, but in Luve farmers are already placing their b Loren Forrest, age 64, is cultivatin small plot of *Giganteus Miscanthus*, a k of grass that can shoot to 12 feet tall i year. He estimates that he could some up his profits by $25 per acre gr ing and selling next-generation ene crops, in addition to his regular corn soybeans.

Shrinking Subsidies?

WHILE FARMERS WAIT for the cellul revolution, they're enjoying the spik commodity prices caused by demand biofuels. Corn has sold for an averag $2 to $2.50 a bushel since the 1970s. agrarian economists predict corn pr will hit a new long-term level nort $3. Across a typical year's crop, that' extra $9 billion going to farmers.

That means that Uncle Sam won't h to kick in as much money to support th since some of the current corn subsi are based on the price of commodi "It depends on how high prices go, subsidies could be cut by $5 billion to billion a year," says professor Christo Hurt of Purdue University. Still, he adm some of those savings will be offset by increasing amount of money the gov ment is spending on biofuel. Today, blenders receive a 51¢-per-gallon tax cr for ethanol.

Economists welcome evidence that green energy boom is slowing the mi tion of young people away from the f The outflow has stopped in North Dak After nearly three decades of losses, population grew in the past two ye Across the country, over the next 10 ye biofuel and wind investment are predi to create more than 250,000 jobs, m

Spotlight on Power Crops

What Comes After Corn: An early ethanol investor, farmer Loren Forrest hopes to build a next-generation plant that can cook up corn waste to make more biofuel more cheaply.

Ethanolville, USA: Field notes from *BusinessWeek* reporter Adrienne Carter's journey through the farm belt's emerging economy.

Energetic Flora: A slide show examining some of the exotic crops that could deliver far more fuel per bushel than corn.

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in nonurban areas. Luverne's 21 million gallon ethanol plant, for example, employs 28 people, with most of the salaries ranging from $35,000 to $75,000 before profit-sharing.

Numbers like those offer real hope to locals like Shannon Mulder. For the affable 22-year-old who grew up outside Luverne, farming means family. And while she was determined to stay near home following high school, sky-high land costs made farming impossible. The town's nonfarm jobs offered little promise. By age 20, Mulder had reached the top hourly wage as a nursing assistant in the maternity ward at the local hospital.

So she entered the renewable energy program at the technical college in Granite Falls, Minn., funded in part by local ethanol plants. Like similar initiatives popping up at community colleges and technical schools across the farm belt, the two-year curriculum covers everything from biology and robotics to chemistry and fluid technology. It also complements the school's programs in wind energy. Nearing graduation, Mulder sees herself operating an ethanol plant someday or working in sales. "The industry is so raw, so open," says Mulder, in her Minnesota drawl. "I want to taste it all."

Kolsrud and the other farmers at Agri-Energy face their own rite of passage. Ethanol's high profit margins, even in light of the recent drops in oil prices, have attracted the attention of Wall Street and other corporate types. But at 21 million gallons, Agri-Energy's plant is just a bit player, and the business model has limitations. For one thing, it's a co-op, making it difficult for farmers to cash out. And co-op rules require members to supply the corn, so investors must be nearby farmers.

So lately, the board and co-op members are discussing a possible merger between Agri-Energy and up to six other producer-owned ethanol plants in the Midwest. It's a deal that could create a massive ethanol player—perhaps second only to Archer Daniels Midland. In time, the plan is to go public with a stock offering. Rumors now flying about a potential sale. Some that if the deal goes through, a $10,0 stake purchased when the plant oper could be worth $240,000.

Kolsrud declines to talk about value of Agri-Energy, but he supports stock offering. Others are content w the current structure—and its stea flow of dividends—and don't want upset the apple cart. One fear is that th will lose control of the operations a the local community may not benefit much once outside investors flood Given the recent performance of sto in the ethanol business, there's also chance that the offering could fall f Kolsrud understands the risk, but thin the farmer-owners must adapt or left behind as the industry consolidat The members are expected to vote on proposal by the end of the year. "They arguing about whether to be rich or v rich," he says. ■

–With Adam Aston in New Y

WHAT **GOOD** ARE BIOFUELS?

Crops that double as energy sources are cheap, abundant, and homegrown. Yet as farmers rush to transform food crops into fuel, some environmentalists have begun to fret. Energy & Environment Editor Adam Aston explains:

What are biofuels?
There are two main types: ethanol, made from corn, sugarcane, or other carbohydrate-rich plants; and biodiesel, which is derived from soybeans or other oil-bearing crops, or even from animal fat.

Can I buy ethanol or biodiesel now?
You may already have it in your tank. About half the U.S. gasoline supply is spiked with up to 10% ethanol. U.S. carmakers are promoting a blend called E85, made of 85% ethanol and 15% gas. But to burn this mix vehicle engines must be upgraded, and only about 800 gas stations carry it. Biodiesel is even rarer: 75 million gallons were made last year, versus 4 billion gallons of ethanol.

SLASH-AND-BURN IN INDONESIA

How "green" are biofuels?
Environmental groups such as the Natural Resources Defense Council like them because, with both E85 and biodiesel, tailpipe pollution and greenhouse gas (GHG) emissions fall. But while air quality may improve, water can suffer. More energy-crop farming may stress already overdrawn water supplies, and increased use of fertilizers could taint surface waters. What's more, as fuel crops rise in value, farmers allot more land to them. In tropical areas such as Indonesia, a boom in biodiesel made from palm oil is encouraging the slash-and-burn clearance of rain forests to create cropland.

Don't you have to consume a lot of energy to make biofuels?
Not really. Thanks to more efficient growing and production processes, the "energy balance" of today's ethanol is positive. For each unit of energy consumed in planting, fertilizing, harvesting, and distilling, ethanol yields about 1.5 units. At 3.0, biodiesel's energy balance is even better. But the Holy Grail is so-called cellulosic ethanol made from woody crops and plant waste. It has an energy balance of up to 36.

Do food supplies suffer if more crops are used to make energy?
So far, the answer is no. Last year, 14% of the corn harvest was used to make ethanol, almost all of it industrial-corn varieties not normally used in food. In some states, though, ethanol plants can process more corn than local farmers can now grow. Worldwide ethanol demand has pushed up the cost of corn by 25% and sugar by 100%. Rising food prices especially hurt the world's poorest nations, many of which depend on U.S. exports.

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The Korean Upstart In MySpace's Face

Cyworld could be a social network sensation in the U.S., if it learns the ropes well enough

BY ELIZABETH WOYKE

TRANSLATING INTERNET services into other languages is old hat. Google Search alone is available in 120 languages. But tailoring a social networking site to fit another culture? That's another thing. Especially when that service is Cyworld Inc., a hugely popular Korean site that has the potential to gain a foothold in the ultracompetitive U.S. social networking market. "We needed to really understand what made this American audience tick," says Michael Streefland, Cyworld USA's vice-president for marketing.

Breaking through will be no small feat. MySpace.com dominates U.S. social networking, with about 123 million users. But the behemoth's appeal may be peaking, and established U.S. rivals are nipping at its heels. Cyworld, which is backed by the deep pockets of South Korea's SK Telecom Co., thinks it can carve out a lucrative spot. And it spent 13 months doing research before its August launch to bolster its prospects. "Some people might consider this a saturated market," says Henry Chon, CEO of Cyworld USA. "But we think we're a nice alternative to these other sites."

Emphasis on the word "nice." If MySpace is like a hip party, where users vie for popularity and attention, Cyworld USA is a relaxed hangout that stresses existing friendships and hosts 2,650 clubs, such as "Interns Unite!" Cyworld gives social networking a twist, combining photo sharing and blogging with digital avatars. An avatar (a little cartoon character called a Mini-Me, à la *Austin Powers*) can be programmed to dance, play, and even sulk in a customizable online mini-room. Koreans often spend hours rearranging their avatars' moods, outfits, and rooms. Cyworld has cashed in on this addiction, selling digital accessories to users to the tune of $120 million in Korea alone last year.

(Nearly one South Korean in three a registered user.) Still, it's a mélan that may not suit every country. "A l of this cutesy stuff doesn't cut it ov here," says David Card, a senior analy at JupiterResearch.

CUTE AND COOL

THAT'S ONE REASON Cyworld embark on its pre-launch odyssey, guided by host of consultants. Look-Look, a you research agency, helped it learn abo American teen culture. Native Instinct digital design firm, scrutinized the sit look and feel. Arlene Atherton, a visu linguistics consultant, analyzed cultu values to translate the site's brand.

Some changes were simple. Pag had to be reorganized to read left right. The fate of the avatars wasn't clear. The Japanese nixed them. B after some initial skepticism, Americ focus groups gave them a thumbs-u The U.S. team made the Mini-Me's old larger, and more ethnically diverse th their Korean counterparts, which ha a more cherubic look. By retaining the Mini-Me's, the site found its niche: teens who equate cute with co While Cyworld's core audience in Ko is twentysomething college kids, the ty cal U.S. user is 13 to 24, female, creati and active in her community.

Cyworld USA sees its focus on who someness as its best chance for trumpi MySpace's free-for-all appeal. So far, has led to steady growth. The compa is adding one new member every t to three minutes and expects to ha 500,000 by February. So while a yea worth of research can't guarantee su cess, the company at least has the sat faction of having done its homework.

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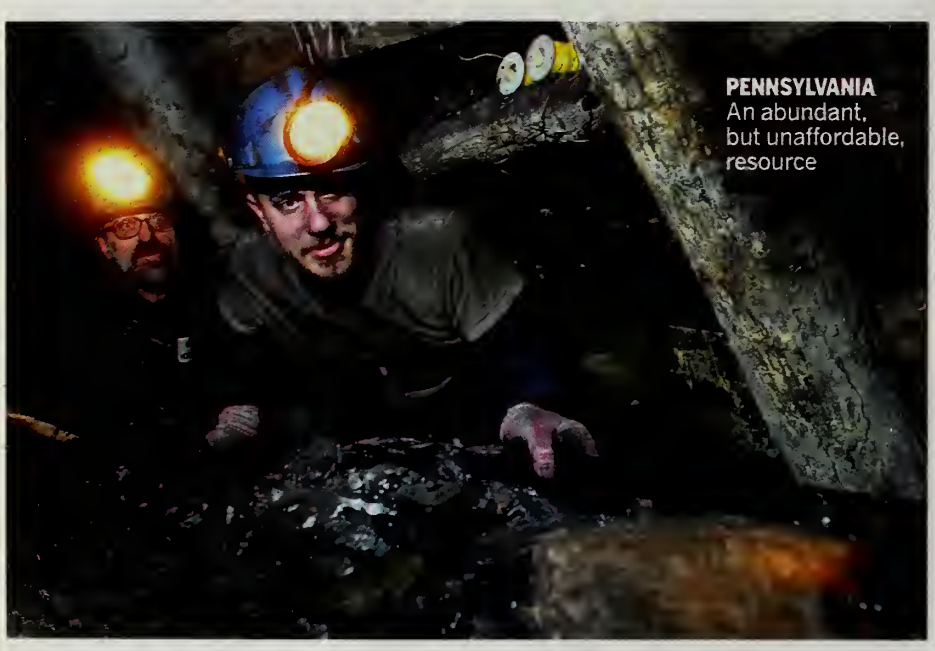
Coal: Could Be The End of the Line

Prices would soar if the U.S. clamped down on carbon emissions



PENNSYLVANIA An abundant, but unaffordable, resource

BY JOHN CAREY

IF VINOD KHOSLA IS RIGHT, THE nation's energy mix may be poised for a profound shift. Like most Americans, the legendary venture capitalist and founder of Sun Microsystems Inc. once assumed that coal was a necessary evil. After all, plants that burn it provide half of the nation's electricity. The U.S. has more than 270 billion tons of the stuff in the ground—a 200-year supply—and utilities have plans to build more than 150 additional plants. Khosla has been funneling cash into biofuels and other forms of green energy. But he says he "assumed that coal was impossible to displace."

Not anymore. Khosla is taking a hard look at the economics of electric power and says he has come away "totally shocked." The era of coal may be ending, he declares: "Nobody in their right minds should be building a coal plant."

Has Khosla gone off the deep end? If so, he's not alone. "It's the definition of financial insanity to invest in a new coal plant," agrees Marc Brammer, head of research for consulting firm Innovest Strategic Value Advisors. Even some utility executives see big risks. "It's very likely the investment decisions many are making, to build long-lived high-carbon-dioxide-emitting power plants, are decisions we'll all live to regret," warns Vice-President Gary Serio of Entergy Corp., which owns several coal plants.

Here's Khosla's argument: Much of the developed world has already imposed curbs on greenhouse gas emissions, and the U.S. is likely to follow suit. The European experience suggests that the cost of emitting a ton of CO_2 is about $20 to $25. Since coal-fired power plants emit more than twice as much CO_2 for the same amount of electricity as natura gas-fired plants, coal gets hit hardest b the curbs. The effective price of coal cou leap as much as sixfold, raising the cost producing electricity by about 50%.

> "Nobody in their right minds should be building a coal plant"
> –*Vinod Khosla*

Many utilities' current proposals fo coal-fired plants don't fully account fo those risks, says Michael J. Bradle founder of the Clean Energy Group, a uti ity association. Those companies "cou be really jeopardizing their stockholder investment," warns one utility executive

Some industry experts see the rash proposals for new coal plants—such as planned by TXU in Texas—as a strate for getting in under the wire. "I think th see a window before the carbon costs hit says Roger W. Gale, president of consul ant GF Energy. The companies hope th can get the plants grandfathered und the rules or pass along the added costs consumers. TXU spokesperson Kimber Morgan says that regulations are yea away, that the company has considere the risks, and that more electricity is ba ly needed. That's why stocks like TXU haven't taken a hit.

Without coal, where will power com from? Khosla's grand vision is to repow the U.S. via solar plants in the America Southwest. The idea: Use thousands acres of mirrors to focus solar energ heating water to drive turbines. An anal sis of new Australian solar technolo suggests that it is cost-competitive ev with today's coal plants. "I'm almost co vinced that the cheapest plant would solar thermal," says Khosla.

Skeptics wonder if Khosla is talki down coal to pump up his investments clean energy. He declines to discu these stakes in detail, but he says: "I on invest in what I believe in." Meanwh utilities have begun seriously explori solar technologies. Austin Energy, for i stance, is now getting bids on a plant up to 50 megawatts.

Investors in coal are starting to fi about the risks of emissions regulatio And some customers are starting to ins that their power come from clean source Witness California's all-green energy i tiatives. That trend cou grow as new scien prompts more dire warnin about global warming. "I never seen a phenomen take over the public co sciousness" like clima change, observes Dav Crane, CEO of NRG Ener Inc., a Princeton (N.J.) util "This is the kind of thi that could stop coal." ■

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200620

Why Bankers Keep Seeing Bears

Their stocks have been strong this year, but earnings are under assault

BY MARA DER HOVANESIAN

YOU WOULDN'T KNOW it from their stock prices, but banks are bracing for bad times. Not long ago demand for mortgages was strong, profit margins were fat, potential acquisitions were reasonably priced, and regulators were off their backs. No such luck these days. The tide is turning so dramatically that some analysts are downgrading the entire sector.

Third-quarter results were underwhelming for banks of all stripes—from tiny community enterprises to the biggest global players. On Oct. 25, the small Portland (Me.)-based TD Banknorth Inc. reported a 3% decline in third-quarter profits, to $86 million, blaming the interest rate environment and an uptick in bad loan reserves. Less than a week earlier, financial-services giant Citigroup reported that third-quarter net income fell 23% as corporate and investment bank revenues dropped.

Tune in to any random earnings call and you'll hear bank executives sounding bleak. Regulators are admonishing them for high concentrations of risky commercial loans and less-than-savory sales practices for mortgages (page 78). Fee income from underwriting and merger advice has been mostly flat, and the credit quality of existing borrowers is expected to deteriorate. "There's no sign of the pressure abating," says analyst Peter J. Winter of BMO Capital Markets, who cut his 2007 earnings growth estimates for large regional banks to 9% before the third-quarter numbers were in, and again to 7% after seeing the actual results.

Despite the heady run for bank stocks—the KBW Bank Index hit a 52-week high on Oct. 4—large regional banks have been the worst performers of all the financial companies in the Standard & Poor's 500-stock index sin July. Blame interest rates. The differen between what banks must pay to borr money and what they can charge wh they lend it out to customers is shrin ing, squeezing profit margins. "Marg pressure has accelerated, and [ban have] drawn down on loan loss reserv for income," explains Steve Rayner, po folio manager of the $300 million IN Financial Services Fund, which invests mid-cap and large-cap banks, as well thrifts. "That can't continue forever."

At the same time, competition for b sic deposits is also crimping business. the third quarter, most of the 50 larg banks struggled with depo outflows as higher short-te rates lured customers in certificates of deposit, mo ey markets, and brokera accounts that pay custo ers more than checking counts, and therefore cost t bank more to stay compe tive. "There used to be ood of deposit growth at minin cost, and banks were flus says Jacqueline Reeves, nior analyst with Ryan Be & Co. "Deposit growth is n tougher to come by, so ban have to pay up."

Tough Outlook for Banks

Analysts are downbeat on profits

BANK	BUY VS. HOLD/SELL RATINGS	CHANGE IN CONSENSUS ESTIMATES FOR 2007 EARNINGS *
BANK OF AMERICA	14/11	$4.98 to $4.94
CITIGROUP	10/11	$4.61 to $4.58
JPMORGAN CHASE	12/10	$3.94 to $3.96
U.S. BANCORP	14/9	$2.83 to $2.81
WACHOVIA	14/12	$5.09 to $5.03
WASHINGTON MUTUAL	3/17	$4.30 to $4.10
WELLS FARGO	18/7	$2.74 to $2.74
COMERICA	4/18	$5.03 to $4.99
KEYCORP	3/21	$3.03 to $3.03
SUNTRUST	4/20	$6.34 to $6.27

*Since Oct. 1 **Data:** Thompson Financial, Bloomberg Financial Markets

PADDING PROFITS?

THE VALUATION picture is rosy, either. For the top banks, the p-e ratio of 13.6 the forward 12 months is 8 of the broader market's mu ple of 15.5; normally it's 7 "I'd be cautious about buy bank stocks," says Freder Cannon, San Francisco-ba managing director for Ke Bruyette & Woods Inc.

The wild card is credit qu ity. What worries David lison of the $400 million F Small Cap Financial Fu is potential credit proble stemming from overburde consumers and, especia homeowners. Many banks, cluding Capital One, Bank America, and Fifth Third, h already warned investors t they expect consumer cr quality to worsen. But by h much? "We're definitely ing to be bouncing aro the bottom for a while, add volatility to earnings," s Reeves, who recently lowe

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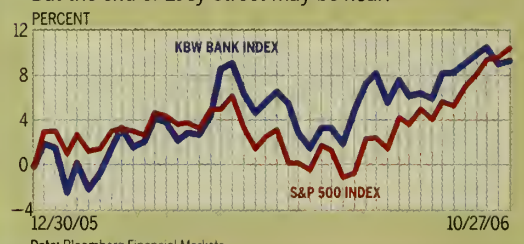
her 2007 earnings estimates for 17 thrifts by an average of 3%. "We're going to see more and more charge-offs."

Some banks and mortgage players, such as Washington Mutual and Countrywide Financial, have recently announced cost cuts. Others are restructuring their balance sheets by selling off securities: Bank of America, for example, announced with third-quarter earnings that it would reduce its securities portfolio by $100 billion over the next several years. Analyst Dick Bove of Punk, Ziegel & Co. notes many banks are easing the pressure by lowering their effective tax rates with financial engineering. Bove writes in an Oct. 25 research report that 32 of the 47 banks reporting by that date saw drops in tax rates in the third quarter, thereby padding profits. It was no coincidence, in his view. "This is an eye-opener for those who do not believe that banks manage their earnings," he writes. "The key question is: How many more quarters will these companies be able to cut costs, reduce tax payments, and buy back stock if revenu keep falling?" His answ not many.

Consolidation may be t ticket out of short-term d drums. If the climate conti ues to be challenging, Wi ter says, more banks mig be willing to sell. While t recent stock run makes a quisitions more expensive also gives banks an inflat currency with which to shopping. "The big thing watch next year is M&A activity," he sa Adds Cannon of KBW: "What could te per any investor bearishness is consc dation. Oftentimes when banks see th operating environment deteriorate, it' pretty good time to find a partner."

TROUBLE FOR BANK STOCKS AHEAD?

Robust bank earnings have propelled stock prices. But the end of Easy Street may be near.



Data: Bloomberg Financial Markets

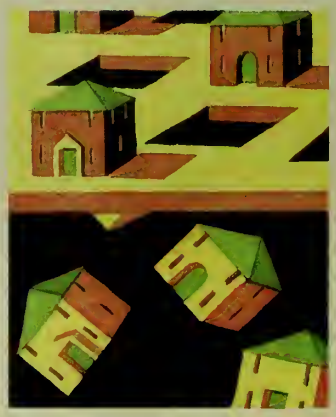
RISKY PORTFOLIOS

Mortgage Lenders Feel the Chill

Accredited Home Lenders Holding Co. notes on its Web site that it hails from "sunny San Diego." But judging from its falling earnings expectations, the skies are threatening. On Oct. 19 the mortgage lender said the slumping housing market would take a bite out of profits. From an original earnings-per-share target of $8 for 2006, the company had warned analysts in August that $4.50 to $5 was more likely; now it says it probably won't reach even the low end of the range.

Accredited ticked off several reasons for the weakness. Loan growth has been lackluster, and competition for the dwindling business has been fierce. Wall Street is no longer paying top dollar for so-called subprime loans made to people with less-than-pristine credit—the bulk of Accredited's business. Worse still, the company has seen more delinquencies than expected on loans generated in 2005 and 2006, which means it has to set aside more money in reserve for bad loans.

Its problems aren't unique. Mark Agah, a senior analyst at New York research firm Portales Partners, says weak third-quarter numbers will be only the beginning of an extended downturn for the industry. "I'm pretty negative on this sector," he says. "There have been a lot of underwriting abuses in this industry, and it's gotten worse as competition has heated up for lower and lower volumes. These companies have a lot of issues."



Expectations are particularly grim for banks that specialize in the risky pay-option ARM, an adjustable-rate mortgage that allows borrowers to make monthly payments that are less than the interest due. Pay-option ARMs weren't a problem in the heyday of the housing boom because rising home prices could come to the rescue. But now that the market has cooled and interest rates are up, some homeowners are finding themselves trapped. By paying only the smallest possible amount toward their monthly mortgage, borrowers actually increase the total balance they owe, a situation called negative amortization. Once a balance grows to a certain amount, the loan resets at a higher payment, in some cases far more than borrowers can afford. With prices falling, many can't sell their homes to get out of the hole. A wave of foreclosures could be in the offing.

Already, the number of loans in negative amortization is spiking at banks such as Downey Financial, Washington Mutual, and Wachovia, hardly bit players in the banking business. Although Downey's pay-option ARM portfolio shrank by almost $1 billion this year, to $12.3 billion by the end of the third quarter, the dollar amount of loans in negative amortization territory increased by 108%. Interest earnings from negative amortization loans at Washington Mutual zoomed 223% from the period a year earlier and jumped nearly threefold at Wachovia. At the nation's largest lender, Calabasas (Calif.)-based Countrywide Financial Corp., pay-option ARM volume is down 23% through the end of September, but so are earnings expectations: The company recently told analysts to expect per-share profits in the range of $4.10 to $4.50, down from $4 to $4.80. "Every indication is that the mortgage business will deteriorate in the coming quarter and years," says Frederick Cannon, managing director at Keefe, Bruyette & Woods Inc. in San Francisco. "The real question is the levels. We know the direction—we just don't know the magnitude."

–By Mara Der Hovanesian

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A Fifth Startup? It's All In a Workday

PeopleSoft founder Dave Duffield is tilting at Oracle—again

BY SARAH LACY

DAVE DUFFIELD WAS alone in a hotel room 3,000 miles from home when he got the news that PeopleSoft Inc., the company he had started and built over 17 years into a software powerhouse, had been snatched away. It was Dec. 10, 2004, and Duffield was preparing to give testimony in a shareholder lawsuit when the call came from longtime colleague Aneel Bhusri. "I've got some very bad news" was all he needed to hear.

PeopleSoft's independent board members had voted to accept an enhanced $10.3 billion buyout from Oracle Corp., the megacompetitor Duffield had taken to calling "the bad guys" because he feared there would be layoffs and product cuts if it took over. He felt like someone had punched him in the gut. "I was in the middle of nowhere," he recalls. "It was totally depressing."

Duffield had put up a good fight. Three months earlier, when he returned from retirement to try to rescue PeopleSoft from Oracle's clutches, many were amazed. Here was a wealthy, retired man in his sixties who, with Bhusri, had turned the reins over to CEO Craig C way back in 1999. He had philanthr and six adopted children at home to k him busy. What did he need with r ning a company again? So when Ora Chief Executive Lawrence J. Ellison nally prevailed in the takeover bat everyone assumed Duffield would retu to Tahoe—with the $600 million more made off the sale.

They were wrong. On Nov. 6, lowing a year of industry speculati Duffield, 66, will launch his latest s ware company. The startup, his fifth called Workday. It's a bold attempt tackle head-on the giants of the busin Oracle and SAP, with Web-based "on-mand" software.

That means taking on the old Peo Soft products, which Oracle still s and supports. Already, Workday be a striking resemblance to Duffield's company. At its offices in Walnut Cre Calif., executives sit in egalitarian cu cles. Many are former PeopleSofties w a strong sense of loyalty: Few forget t following the buyout, Duffield put up million of his own money to help laid workers. Today, CEO Duffield roams halls in jeans and a golf shirt. Just in the early days at PeopleSoft, it's as Midwestern company has been plun down on the edge of Silicon Valley.

Attacking Oracle and SAP, which h 65% of the market for big-company plications, is an idea that would get m people laughed out of a venture capi ist's office. Fortunately, Duffiel worth an estimated $1.2 lion. Bhusri, who is b as co-founder, a partner

RETIRE, ME? His new venture is a chance to sell software building blocks

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SNAPSHOT

)ave Duffield

)RN Sept. 21, 1940, Cleveland.

)UCATION BS, science and electrical gineering; MBA; both from Cornell.

AREER His first job was as a low-level gineer at IBM. Went on to start five sinesses, including, most recently, the ftware company Workday.

G SCORE Duffield made almost all his 2 billion fortune from creating PeopleSoft. ughly half came when Oracle bought the mpany in December, 2004.

MILY He and his wife, Cheryl, have nine ldren, from 6 to 40; six grandchildren; ee dogs; two fish; and a parrot.

ING YOUR FAMILY TO WORK ffield's wife, brother, and two children rked at PeopleSoft. Son Mike and ughter Amy followed him to Workday.

ILANTHROPY Created ddie's Fund, a pet rescue ndation, and gave it $300 lion. When he was poor, ffield made a promise to his st child," a schnauzer named ddie (right), that if he ever de money he'd make life better her kind.

ure firm Greylock Partners, h jumped at the chance to Duffield's next act. So far nd Greylock have ponied 15 million and expect to invest $20 on more by yearend. Why get back in ame? "I had a good life, my kids were y, and I could hold my head up high t what I accomplished at PeopleSoft," ield says. "I wouldn't [risk all that] s there was a real opportunity."

AD OF THE CURVE

T OPPORTUNITY is to catch the soft- business at a new inflection point. leSoft came along when human re- es and other business applications moving from mainframe computers s. It quickly became a leader in easy- e programs that automate HR tasks as the administration around hiring, , and performance reviews. For its PeopleSoft produced programs that remarkably easy to use and custom- hen it rocketed to No. 2 in software oader use in corporate applications, as accounting, factory planning, upply-chain management.

Shortly before its sale, PeopleSoft had 13,000 employees and $3 billion in annual revenues. In 2003, PeopleSoft attempted to widen its lead by buying a smaller competitor, J.D. Edwards. Ellison launched a hostile bid for PeopleSoft that stunned the industry. Conway resisted vigorously but alienated shareholders who felt he needed to consider the escalating offers. Finally the board fired Conway and turned to Duffield. He opposed a sale, but was overruled by independent directors.

Fast forward to today: Corporate software packages have grown increasingly complex and expensive to maintain. Frustrated employers are turning to on-demand software, which is easier to use and cheaper long-term. Sellers run programs for customers, taking on the cost and hassles of operating databases and servers. Users log onto the Web to pull down information on payroll or figure out where an order is in the sales pipeline. At the same time, a new, more flexible style of programming is emerging that takes advantage of software building blocks. As companies grow, they can move pieces around without breaking up the whole system. Workday will try to exploit those changes.

But the idea that Web-based technologies can improve software isn't exactly original. A handful of promising young companies—salesforce.com, RightNow Technologies, and NetSuite, to name a few—are gaining share with midsize companies. And SAP, Oracle, and Microsoft are retrofitting their programs.

So Workday has its work cut out. The largest of its five customers is Biosite Inc., a biotech company with 1,100 employees. To build customer confidence, Workday needs to forge relationships with big software and services outfits. It's in talks with Microsoft to figure out how to get Workday software to mesh with its ubiquitous desktop programs. And Accenture Ltd. is building a Workday practice to help big companies evaluate and implement the programs, a sign that it thinks Workday is on to something. "We think this is a huge opportunity," says Bob Suh, Accenture's chief tech strategist.

Still, Workday's best asset is Duffield's reputation as a software legend. Early on at PeopleSoft, he did much of the coding himself and personally manned booths at trade shows. His last slide at customer conferences showed his direct phone line (and, later, his e-mail). "There really is a cult following around Dave," says AMR Research Inc. analyst Bruce Richardson. "If anyone can do this, it's them."

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How Tony Hawk Stays Aloft

It's no mean trick to be a youth icon at 38. Can the skateboarder keep his franchise booming?

BY MARK HYMAN

AT 38, TONY HAWK MIGHT seem a bit long in the tooth for a skateboard icon. But don't think that has slowed the extreme sports hero down even one RPM in the product endorsement arena.

On Nov. 7, Hawk's fans can point their boards to the video-game store and pick up the latest in his hot-selling series, *Tony Hawk's Project 8*. *Tony Hawk's Downhill Jam* shipped in October. Hawk also has a new direct-to-DVD movie in stores (*Boom Boom Sabotage*), a clothing brand for boys (at Kohl's Corp.), a weekly satellite radio show (4 p.m. Pacific on Sirius)—and even a deal that supplies cell-phone users with Hawk-inspired ringtones.

Wait, there's more. Ready for the Tony Hawk thrill ride? Six Flags Inc. tells *BusinessWeek* it will launch the attractions, billed as a "total Tony Hawk experience," at two parks next summer.

Hawk's deals, which earn him from $5 million to $7 million a year, according to marketing insiders, rank him among the richest pitchmen in any sport. What sets him apart even from that elite company, though, is his pipeline to young consumers. Strangely, for a father of three closing in on 40, Hawk hasn't lost his juice with kids, a trick few aging sports celebs have mastered. But hero worshippers are notoriously fickle, and Hawk faces challenges as he works to hold on to his cultish following. The most daunting: how to build his brand and cash

GOOD SKATE
Death-defying stunts are still i Hawk's reperto

in big while av ing deals that doubt on his ico clast image.

For that rea Hawk has stee clear of some me deals. He isn't ing to join the team, says Pat Ha the skater's sister, is COO of Tony Hawk in Vista, Calif. "Tony H wouldn't be Tony Hawk if had a swoosh on head to toe," points out. But skeptics are talking ab Hawk's recent deal with midmarket clothing retailer Kol questioning whether it may cost him precious skate cred.

Still, Hawk is flying high for now. "Anyone who doesn't k Tony Hawk lives in a cave!" says Cole Sprouse, 14, the TV a who with his twin brother, Dylan, last summer launched *C* a general-interest magazine for the young. Dylan adds *Code*'s debut issue included an interview with Hawk beca "in all truth, when you put Tony Hawk in a magazine, kids so likely to grab it."

So what's the source of Hawk's lasting appeal? Start with

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eer status. Hawk was hardly the first n a skateboard. But when he started 975, public awareness of the sport almost nil. At the time, there were r than 40 professional skaters, and nedia showcases that have given ex- e sports national exposure, ESPN's ames and the Dew Action Sports , were decades away.

ıen there's the fact that Hawk is still ıently found performing a death-de- ; Frontside Ollie Nose Blunt. "Tony k is a legendary name, yet he's still and on the scene. People pay hom- o that," says Marshal Cohen, chief vst at NPD Group Inc., a market rch company in New York.

ASING PARENTS

K WAS THE HEAVYWEIGHT champ s sport through the 1980s and '90s, ıg to the No.1 ranking in vert skating steep sloped track) 12 straight years ıgh 1999. He hasn't skated competi- since 2003, though he performs at exhibitions and on videos put y his production company. "He lives ıreathes the lifestyle that these kids ther doing or want to do," says Jeff president of Javelin Group, an Alexandria (Va.) sports marketing company.

Hawk has also pulled off the near-miraculous feat of being as popular with parents as he is with their offspring. In a sport with an ethos of rebellion against school and adult authority, Hawk's clean-cut style stands out. "Parents are thrilled to look at this guy not tattooed up head to toe, a guy who wears a helmet when he skates. That's the one they want their kid to think is cool," says Pat Hawk.

Hawk started skateboarding at 9, entered his first competition at 11, turned pro at 14, and won the world championship a year later. But it was a video game that turned him into a pop culture giant. In 1999, Santa Barbara (Calif.) publisher Activision Inc. put out *Tony Hawk's Pro Skater*. By 2000 it was a best-seller, outstripping such franchises as *Madden* and *Mario*. Hawk's game has rung up sales of $1.1 billion, and Activision's agreement

PLAYBOOK: BEST-PRACTICE IDEAS

Tony Hawk's cool brand-building moves

DO'S

» **STAY ACTIVE.** Hawk continues to perform as a high-flying skateboarder, though not in competition.

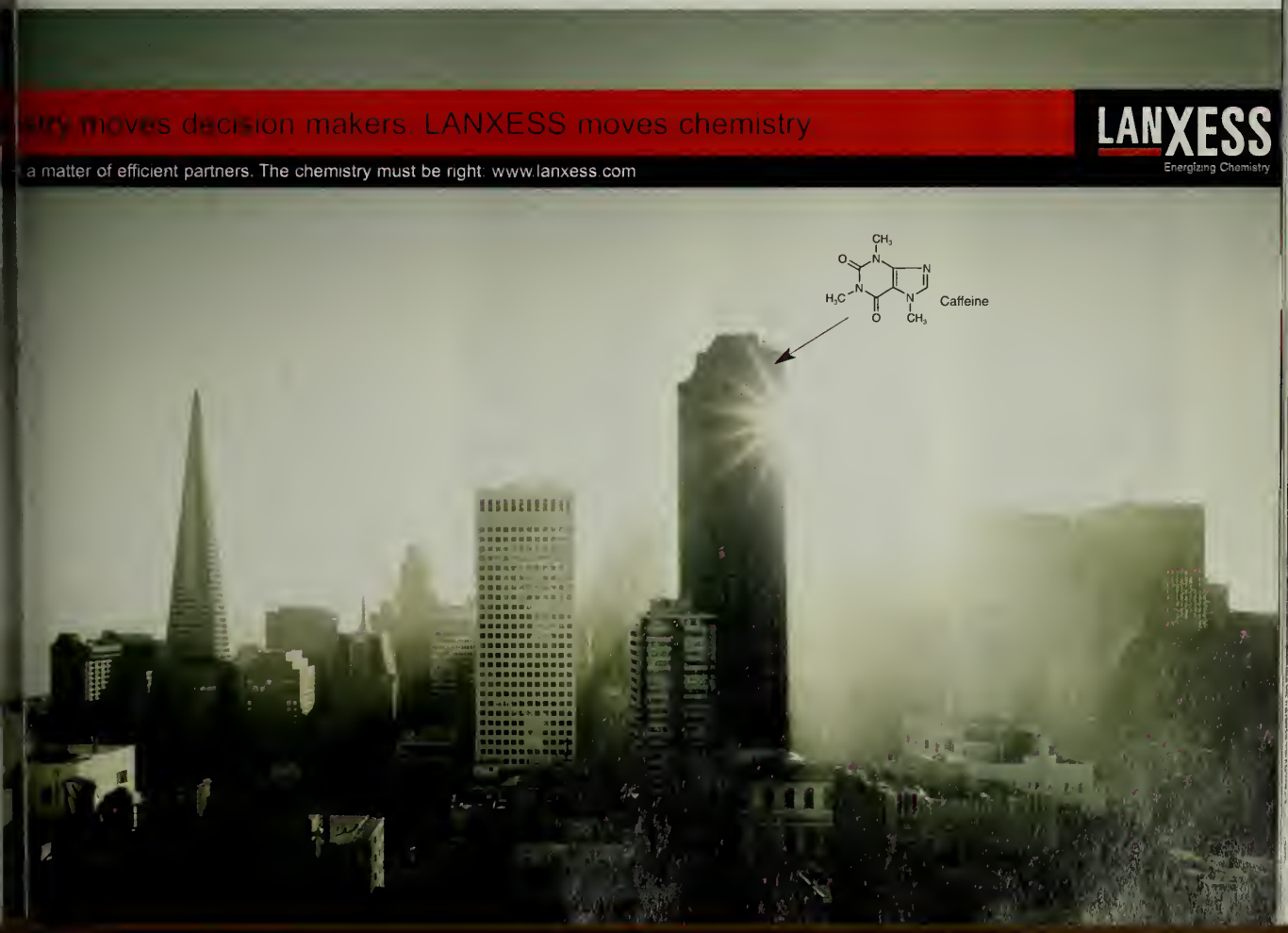
» **POLISH THAT IMAGE.** Hawk embraces the sport's rebel ethos, but he's not scary. His clean-cut style makes him popular with parents as well as his teen and preteen fans.

» **KEEP IT REAL.** Hawk's main celebrity vehicle is his video games, which he monitors closely to make sure every detail rings true.

DON'TS

» **LOOK TOO COMMERCIAL.** To avoid the cardinal sin of looking like a sellout, Hawk has avoided megadeals with companies such as Nike.

» **FORGET YOUR BASE.** Hawk clothes are available in more stores at lower prices after a deal with Kohl's this spring. But will diehard Hawk fans shop a mass retailer?

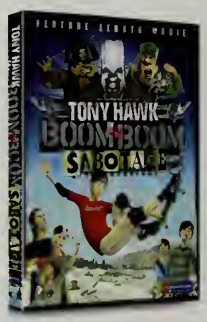


with him has been extended to 2015.

The Activision games also stretch the Hawk brand far beyond kids with crash helmets in their closet. About 75% of the game's players don't even own a skateboard, says Will Kassoy, vice-president for global brand management at Activision.

Hawk's contribution to the video games, beyond his name, has been to insist on realism. Everything must mirror real skating, down to the paint jobs on the decks. "I'd played video games since *Missile Command* in the local arcade. When I got a chance to work on a game, I wanted it right," he says.

Likewise, he labors over *Boom Boom HuckJam*, an extreme-sports megashow on wheels that Hawk launched in 2002. A showcase for himself and other skaters and bikers, the show toured eight Six Flags parks last summer and is scheduled to return in 2007.



HAWK AWAY Among the Tony Hawk products: kids' clothes, videos, and video games

Some of Hawk's deals appear to be less about skateboarding than cashing in, though, and they can make diehards wince. There's the Tony Hawk birthday party collection—paper cups and plates. (Eight 9-inch plates go for $3.10.)

The recent clothing deal with Kohl's also smells like a sellout to some. The skater's line of sh pants, and hoodie the shelves at the r retailer in March. fore that, Hawk handled by Quiks Inc., a maker of tre action sports app "His biggest risk is ing control of his b image," says Jave Bliss. "If I were I'd never have allo Quiksilver to h off [the clothing Kohl's."

Hawk, of cou defends the decis "We wanted to be expensive, less ex sive." Still, he ad there have been iss After some early p shoots, Hawk says, "we had to expla them: 'If you do it your way, the core into Hawk clothing will be wonde 'What's wrong with those guys?'" W you're a late-30s star building a b aimed at teens, you can't have fans ing that question. ■

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BONUS SUPPLEMENT: GOLF & THE BUSINESS LIFE

usinessWeek | Golf Digest

WINTER 2006

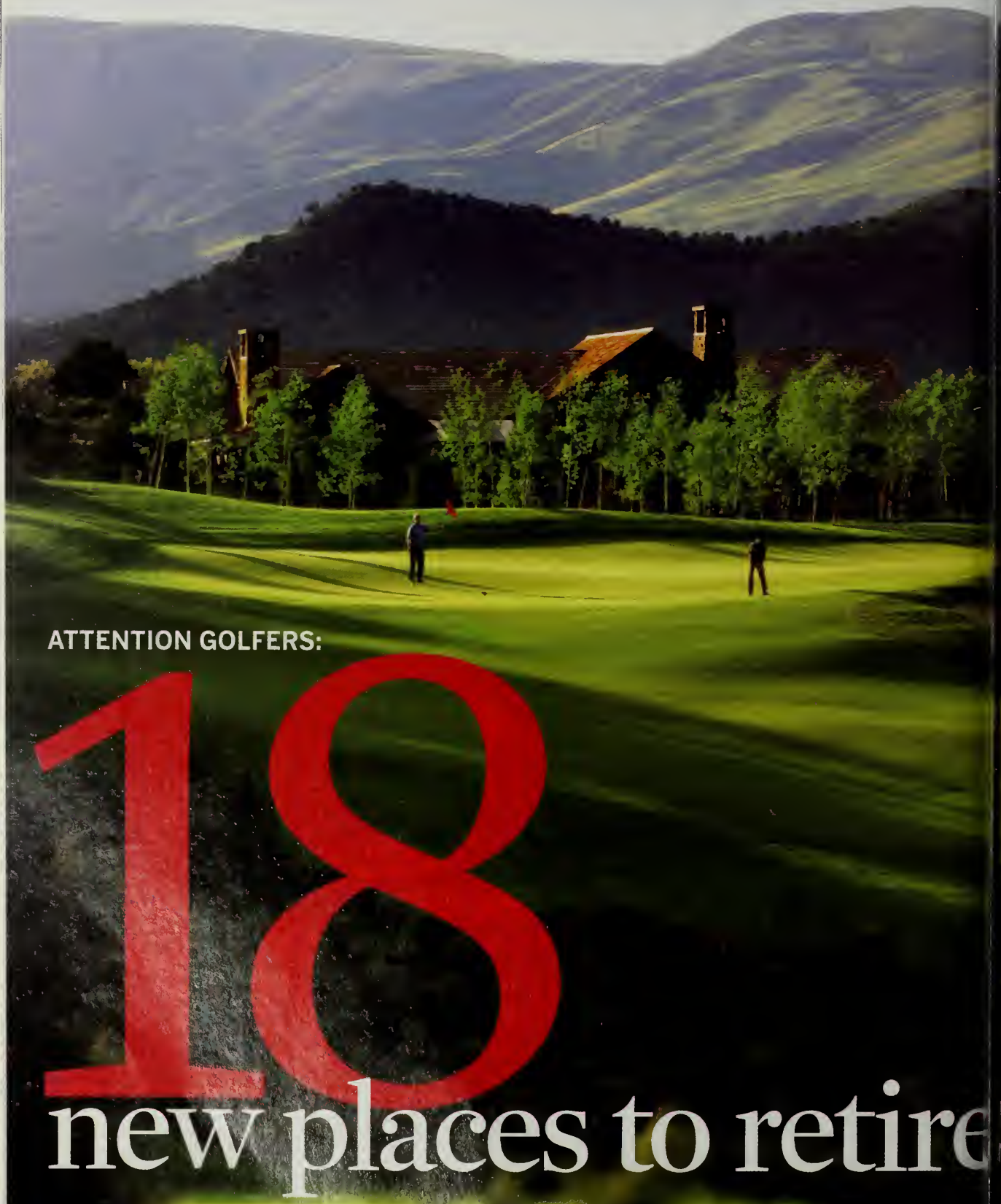
Smart New Places to Retire

SIDE

- GOLF'S ENTREPRENEURS: A RISKY BUSINESS
- HOW TO BE A SAVVY GOLF COLLECTOR

PEN GLEN, IN CARBONDALE, COLO.

RED SKY RANCH, NEAR VAIL, COLO.
INSET: SEVEN CANYONS GOLF CLUB,
IN SEDONA, ARIZ.



ATTENTION GOLFERS:

18 new places to retire

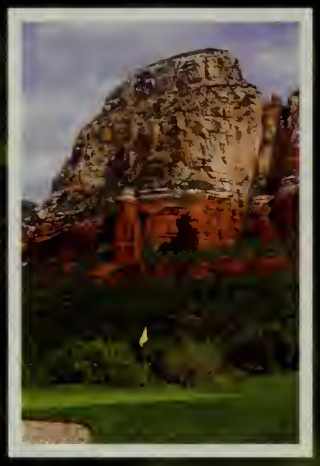
PHOTOGRAPHS: ASPEN: DICK DERRANCE; RED SKY: COURTESY OF COURSE; SEDONA: DOM FU

We reveal the latest regions to
e baby boomers at leisure

By Ron Kaspriske

TOM HEAD HAS BEEN LIVING IN Boca Raton, Fla., for 35 years. Within a short drive of his house are dozens of golf courses. Since he's an avid golfer pushing 60, you'd think Tom was in the ideal spot for retirement, but he and his wife, Rita, think they've found something better.

"In addition to golf, we also like to ski, so we visited Red Sky Ranch a few winters back," says Tom, of the 700-acre golf course community set in a valley alongside the Rocky Mountains near Vail, Colo. "You couldn't even see the golf course that day because of the snow, but we knew this was where we wanted to be. It was so much more quiet and peaceful, and we were surprised to find a lot of quality golf out here. It made more sense than living in Boca year-round."



Tom and Rita did not know it then, but they were at the start of a trend when they chose Colorado ski country for their second/retirement home. The Glenwood Springs-Breckenridge area of Colorado, which includes famous resort towns Vail and Aspen, is No. 1 on *Golf Digest/BusinessWeek*'s 2006 ranking of the 18 hottest retirement destinations for golfers. The ranking was compiled with the help of the Longitudes Group, a market research and consulting company in Omaha, specializing in sports, travel, and leisure. The ranking takes into consideration the number of golf courses built since 2000, as well as new courses in the planning or construction stages. That data is then coupled with such quality-of-life statistics as safety, weather (playable golf days), culture, health care, and airport access.

While many retirees are still flocking to traditional places such as Scottsdale, Ariz., Palm Springs, Calif., Myrtle Beach, S.C., and Naples, Fla., to get their golf

fix, many others are now looking for spots that offer quality of golf and quality of life, but are far less congested. Glenwood Springs-Breckenridge is just one of many regions across the country where new golf-course construction has been matched recently by home purchases from baby boomers. Like Glenwood Springs or Vail, these are places you might not immediately associate with golf.

"This whole boom seems to be driven by the anticipation of the coming onslaught of baby-boomer retirees," says John Rooney, PhD, co-founder of Longitudes Group. "In addition to the golf opportunities, which seem to be growing rapidly in a number of places, improved airport access, less congestion, and a perceived or real improvement in quality of life are fueling this trend. This is just the beginning."

Adds Andrew Schiller, PhD, a geographer who created neighborhoodscout.com, a Web search engine for people looking to move: "Increasingly, people of retirement age are looking to live near 'real' towns and cities. Places with character that are off the beaten path. They don't want plastic, retirement-only communities. They want places that are safe, clean, friendly, not crowded, and rich in services and amenities—golf included."

Of the 18 places on the *Golf Digest/BusinessWeek* list (table, page 98), here is a snapshot of seven hot retirement destinations across the country:

Glenwood Springs/Breckenridge, Colo.

RED SKY RANCH HAS RECEIVED A LOT OF ATTENTION since it opened in 2002, but it's not the only golf development to make this area a viable retirement destination. Within the ski region are seven of Colorado's top-20 golf courses, as ranked by *Golf Digest*: Roaring Fork (Basalt, No. 11), The Summit Course at The Club at Cordillera (Edwards, No. 14), Breckenridge Golf Club (No. 16), Maroon Creek Club (Aspen, No. 17), Aspen Glen (Carbondale, No. 18), Ironbridge (Glenwood Springs, No. 19), and Raven Golf Club at Three Peaks (Silverthorne, No. 20). Ironbridge and another newcomer of note, Snowmass Village Club, are among nine other courses that are being built or have been built in the ski country since the start of 2000. Most are in housing developments.

Red Sky Ranch offers two golf courses designed by Tom Fazio and Greg Norman, ranked sixth and ninth, respectively, in Colorado by *Golf Digest*. It also has a David Leadbetter Golf Academy and is a 20-minute drive to the charming shops, restaurants,

MAUNA KEA'S SOUTH COURSE, ON THE BIG ISLAND OF HAWAII

and ski resorts of Vail. Red Sky is close to Ea County Airport, which is serviced with nonstop flights from 14 U.S. cities.

At Red Sky, prices typically start in the millions homes and about $725,000 for one-acre homesi Roaring Fork, a Jack Nicklaus course and priv club, has timeshare opportunities in on-site cabi or they can be purchased for year-round living $2 million and up. Despite the high prices, b boomers are attracted by the mild summers and courses that are less crowded than in such areas Palm Springs, Scottsdale, and Austin, Tex.

The biggest downside to the region is obviou the short season (May to October), and traffic in winter on Interstate 70, U.S. Highway 24, and area's other main arteries makes travel difficult. I in the summer it's much more peaceful, and the cent profusion of new courses makes it an attract golf-retirement destination.

Kona-Kohala Coast, Hawaii

THE BIG ISLAND OF HAWAII FEATURES NEARLY EV type of climate and topography, including sn capped mountains; tropical rainforests; bre beaches; arid, wind-swept plains; and erupting canoes. But it's the irruption of golf-course devel ment on the windward side of the island that made retiring golfers take note. Tourists have l known the area as a golf destination. Famous cour

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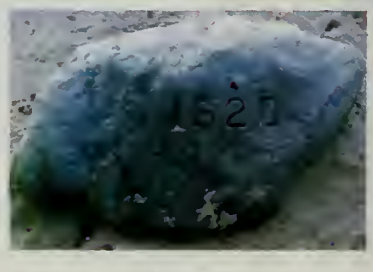
such as Mauna Kea (No. 3 in Hawaii), Hualalai Nicklaus (No. 10), and Mauna Lani North (No. 15) have been host to many professional tournaments as well as millions of vacationing golfers over the years. Many of those tourists who are of retirement age, particularly from California, have decided that if Hawaii is good enough for a two-week vacation, then it's good enough for a permanent home.

Golf is a key attraction. Since the start of 2000 the west side of the island has grown by 144 holes, including a second course at the Four Seasons Hualalai Resort in Kailua-Kona. Jack Nicklaus designed the first course there in the late 1990s, and Tom Weiskopf completed a second one two years ago. Also new to the area is the Kuki'o Golf and Beach Club, a private, Tom Fazio course. Most courses in the area are open to the public, however, and the views of the Pacific Ocean are stunning as the island gently rises from the beach up toward the peaks of Mauna Kea, Hualalai, and Kohala, three of the island's five major volcanic mountains. The red glow of molten lava sometimes can be viewed at night crashing into the sea. Such lava flows pouring down the countryside have created some of the most interesting hazards you'll ever encounter in golf. On most of the area courses, hardened lava rock, which has turned black, borders fairways and sometimes cuts across them.

Real estate isn't as high as you might think. It's possible to get a three-bedroom house with a water view for under $700,000. When you couple those prices with the warm weather year-round, the only drawback to Kona might be the five-hour flight from the continental U.S. For some, that's a bonus.

Plymouth County, Mass.

THE PILGRIMS KNEW THIS WAS A GREAT PIECE OF LAND, but it took retiring golfers nearly 400 years to figure it out. Situated 40 miles south of Boston and 33 miles north of Hyannis, on Cape Cod Bay, the city of Plymouth and its surrounding county is now one of the most desirable retirement destinations for golfers in the U.S. At the heart of the retiree influx is a new master-planned community called The Pinehills, which offers condos starting in the $300,000 range and homes at a little more than $500,000. The community has three courses, including two public tracks designed by Rees Jones and Jack Nicklaus. Both are among the best public courses in the state, receiving 4½ stars in *Golf Digest's Best Places to Play* guide. The community's third course is even more highly re-



THERE IS A LOT OF HISTORY IN PLYMOUTH, MASS., ON THE COAST BETWEEN CAPE COD AND BOSTON

garded—the Old Sandwich (Club, a Ben Crenshaw-Bill C design that finished fourth *Golf Digest*'s 2005 list of Best M Private Courses in the U.S.

Another of the area's key attractions is Waverly O which opened in 1998 and received 4½ stars in *Places to Play*. Joining the roster a few years ago the city-owned Crosswinds Golf Club. It starte 18 holes, but has an additional nine under consti tion.

The appeal of Plymouth is not just the new cou but its easy access from New York, Boston, and C necticut. Unlike Cape Cod, which requires cross one of two bridges for access, traffic is not a m concern in the summertime. The weather makes golf season at least six months long, and the coa location makes winters milder than other New E land areas.

Fort Walton Beach/Panama City, Fla

ALL IT TAKES IS ONE LOOK AT THE POWDERY, SUG sand beaches and the aquamarine waters along Florida Panhandle coastline to know why reti have discovered this 60-mile stretch along U.S. For golfers, there's the bonus of roughly 20 r courses built since 1999 in a region that alre boasted a sizable roster. Panama City also recently

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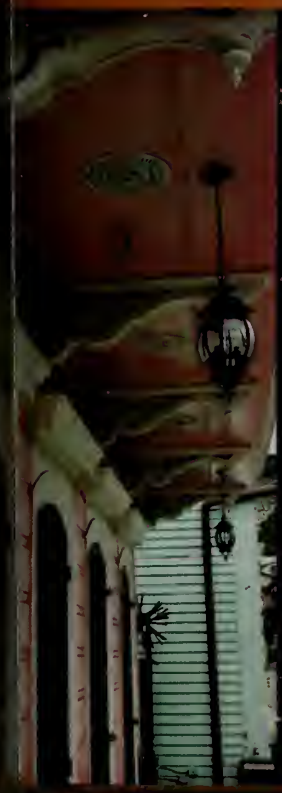

A CLOSER LOOK:
The top 18 emerging golf retirement regions

Ranking	Region	Metro area	Nearby cities and towns	Golf & nongolf total score	Real-estate dev. courses	High-quality private courses	*Public courses rated 3.5+	Access: Golfers per 18 holes	Real-estate dev. score (12.5)	High-quality private score (5)	Public courses score (10)	Access score (12.5)	Playable days (10)	Golf total score (50)	Cost of living (7.14)	Crime (7.14)	Congestion (7.14)	Arts & culture (7.14)	Medical access (7.14)	Scenic & recreation (7.14)	Airport access (7.14)
1	MW	Glenwood Springs/ Breckenridge, Colo.	Includes Vail, Aspen	83.5	10	10	11	704	12.5	4.5	10	9.0	6.2	42.2	4.1	7.1	7.1	5.6	6.5	7.1	3.8
2	W	Hawaii (Big Island)	Kona	78.8	8	3	11	714	11.5	2.4	10	8.9	10	42.8	2.5	6.3	6.9	6.8	3.4	7.1	3.0
3	SW	Hill Country, Tex.	W. Austin, Bee Cave, Marble Falls, Llano	76.0	15½	11	5	2,159	12.5	5.0	6.3	4.6	8.6	37.0	6.0	5.4	3.0	7.1	6.1	5.5	5.9
4	NE	Plymouth County, Mass.	Plymouth	73.7	9	10	8	1,396	12.0	4.5	8.1	6.5	5.5	36.6	2.5	5.5	3.5	6.6	7.0	6.1	5.9
5	SW	Montgomery County, Tex.	Conroe, The Woodlands	73.2	20	8	4	1,763	12.5	3.9	5.6	2.5	9.0	33.5	5.0	4.1	3.3	7.1	6.6	6.5	7.1
6	MW	Douglas County, Colo.	Castle Rock	73.1	8	6	6	2,676	11.4	3.3	6.9	3.3	6.4	31.3	3.9	6.7	5.2	6.3	6.6	7.1	6.0
7	MW	Coeur d'Alene, Idaho	Coeur d'Alene	71.7	8	1	4	999	11.5	1.0	5.6	7.5	5.1	30.7	6.9	5.1	5.4	4.9	6.2	7.0	5.5
8	FLA	Fort Walton Beach/ Panama City, Fla.	Includes Destin, Niceville	70.4	21½	1	10	872	12.5	1.0	9.4	8.3	9.0	40.2	7.1	4.0	4.5	3.4	4.3	3.5	3.4
T9	SE	Greene, Morgan, Putnam Counties, Ga.	Greensboro (Reynolds Plantation)	70.2	8½	2	8	1,422	11.8	2.1	8.1	6.5	7.9	36.4	5.4	3.1	5.8	4.9	5.3	4.4	4.9
T9	MW	St. George, Utah/ Mesquite, Nev.	St. George	70.2	8	1	5	721	11.5	1.0	6.3	8.9	6.6	34.3	6.3	7.0	6.0	3.1	3.4	6.6	3.5
11	MW	NW Arkansas/ Branson, Mo.	Bentonville, Branson, Fayetteville	68.2	20	3	4	1,147	12.5	2.4	5.6	7.0	7.3	34.8	6.5	4.5	4.9	4.1	4.1	5.5	3.8
12	W	N. Arizona	Flagstaff, Sedona, Prescott	67.9	16½	7	3	475	12.5	3.6	5.0	10.5	6.0	37.6	4.0	5.0	5.8	2.5	2.8	7.1	3.1
13	SE	Coastal Southeast Georgia	Brunswick, St. Mary's St. Simons Island	67.0	8½	3	6	710	11.8	2.4	6.9	9.0	8.6	38.7	6.8	3.2	3.6	2.9	3.1	4.2	4.5
14	SE	Richmond, Va.	Richmond	66.9	8½	5	4	2,318	11.8	3.0	5.6	4.2	7.9	32.5	4.4	3.0	3.4	6.5	6.5	4.0	6.6
15	W	Plumas County, Calif.	Quincy	64.7	7	1	3	529	11.0	1.0	5.0	9.9	5.7	32.6	4.0	6.5	7.1	2.0	2.5	5.5	4.5
16	FLA	Palm Coast, Fla.	Palm Coast	62.1	7	3	3	2,628	11.0	2.4	5.0	3.3	8.8	30.5	6.5	5.0	4.5	3.5	3.5	4.6	4.0
17	MW	Park City, Utah	Park City	61.2	3	4	0	1,167	7.5	2.7	0.0	7.0	6.3	23.5	4.1	4.3	7.0	6.0	4.5	7.1	4.7
18	MW	Dane County, Wis.	Madison	60.2	5	6	4	2,109	9.3	3.3	5.6	5.0	5.1	28.3	4.8	3.3	3.5	6.5	6.5	3.5	3.8

Ranking is based on an equal weighting of golf and nongolf (qualify of life) factors. Maximum points for each criterion listed in parentheses.
*Golf Digest's Best Places to Play

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BUCKLE UP

nounced it will start construction on an international airport in 2007, opening up the area to more direct flights. And the cost of living is among the lowest of any major retirement area.

Camp Creek Golf Club, opened in 2001, is the area's best. The Tom Fazio-designed course, which is roughly halfway between Fort Walton Beach and Panama City, is ranked 30th in the state by *Golf Digest*. The club owners say it will soon be expanded to 36 holes. The first course is private but open to guests of WaterColor and WaterSound Resorts. Homesites at Camp Creek are being offered for less than $300,000.

Of the newest courses in the region, the highlight is a 2005 Gary Nicklaus redesign of Bay Point Resort's Lagoon Legend course in Panama City. It remains the only course on the Panhandle with the Nicklaus name. It was given 4 stars in *Golf Digest's Best Places to Play* guide. Bay Point's Meadows Course also will be redesigned in 2007. Another popular new addition to the region is Windswept Dunes in the bayside town of Freeport. The public course was built on 750 acres of sandy terrain that includes 20-foot high dunes. It's 7,607 yards from the tips, the longest course in Florida.

There are many desirable towns along the Gulf Coast, but Destin, 10 miles from Fort Walton Beach, remains the gem of the area. It has lost some of its sleepy, resort-town feel because of the influx of new residents, but it's still a small town in comparison with more well-known retirement areas such as Naples/Fort Myers and the Palm Beaches. Around Destin there are several courses, including three very good ones at the Sandestin Resort: Burnt Pines, The Raven, and Baytowne. All three received four stars or more from *Golf Digest*. Beachside condos at San tin start at $530,000.

STONEBRIDGE MEADOWS, IN FAYETTEVILLE, ARK.

BAY POINT'S LAGOON LEGEND COURSE, NOW CALLED THE NICKLAUS COURSE

Northwest Arkansas/Branson, Mo.

YOU MIGHT NOT HAVE HEARD OF BENTONVILLE, A but it's a safe bet you've heard of the company calls the northwest Arkansas town its headquart Wal-Mart. The retail giant, and all the commu growth it has brought in—jobs, new homes, etc.— big reason golfers have turned this area into a tre retirement destination. The region, which inclu the resort and entertainment town of Branso southern Missouri, is also rapidly becoming kn for its golf. There are more than 47 courses in a mile radius from Fayetteville, Ark., to Branson. Lake of the Ozarks region, including Mark Tw National Forest, makes it a very scenic place to liv

The top golf choices are Stonebridge Meadow Fayetteville, ranked 10th in the state by *Golf Di* and two Branson-area courses: The Club at P Cima (Lake Ozark, No. 7 in Missouri) and Bran Creek (No. 8). Stonebridge and Branson Creek open to the public, and each received 4½ stars in *Places to Play*. Porto Cima is, by far, the region's l course, and the community that surrounds the J Nicklaus course on Lake of the Ozarks has ho that sell for under $500,000. Also not far from the gion is Big Creek Golf and Country Club in Moun Home, Ark., ranked fifth in the state by *Golf Di* and a five-star course in *Best Places to Play*.

Two new courses in Northwest Arkansas are getting a lot of attention: Shadow Valley Co try Club, designed by Jerry Slack, in Rogers the Robert Trent Jones Jr.-designed Blessings (

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Club in Johnson. Shadow Valley is part of a master-planned community with three-bedroom condos for less than $300,000, and Blessings is a 7,500-yard monster.

Golf season is about nine months, and the entertainment options in Branson rival anything short of Las Vegas. The resort town is a hotbed for country-music acts, and its only real drawback is the lack of a major airport accessible from many big cities. Fayetteville has a regional airport, and Branson is opening one in 2008.

Northern Arizona

FROM THE DESERT OF SEDONA TO THE pine forests of Flagstaff, the varied climate and topography of Northern Arizona has been stealing 50-somethings from traditional Arizona retirement spots Scottsdale and Mesa for some time. But golfers started paying even more attention to Prescott, Sedona, and Flagstaff in recent years as 108 new holes have been built since the start of 2000.

The four newest additions to the region worth noting are Seven Canyons in Sedona, Pine Canyon Club and Flagstaff Ranch in Flagstaff, and Talking Rock Ranch in Prescott. All four are private real-estate developments with homes starting in the $500,000 range. Seven Canyons, a Tom Weiskopf design, is the most striking with a 6,746-yard routing through the red rocks that make the area famous. Weiskopf, who is not someone to gush over anything, said the property "took my breath away" when he first saw it. Pine Canyon, which opened in 2004, and Talking Rock Ranch (2002) were designed by Jay Morrish. His previous work in Arizona includes Forest Highlands in Flagstaff, whose Canyon course is ranked No. 1 in the state by *Golf Digest*, and TPC of Scottsdale (home of the PGA Tour's FBR Open). Talking Rock ranks 19th in Arizona. Flagstaff Ranch, a Jerry Pate design, opened in 2004.

While private clubs are sprouting rapidly, the area also has a lot of public courses, including two in the tourist town of Sedona—Sedona Golf Resort (4½ stars in *Golf Digest's Best Places to Play*) and Oakcreek Country Club (4 stars).

Aside from the golf, Arizona is an adult play-

A CABIN LIVING ROOM AT GRIZZLY RANCH, IN PORTOLA, CALIF.

ground with the Gr Canyon less than an h from Flagstaff, and Vegas, the Hoover D and Lake Mead Nati al Recreation Area a few hours away. W Sedona offers incred views of red rock bu as well as a bohemian ist community, Flags is more of a pioneer to with bearskin rugs co ing the floors of log-ca homes. It snows in F staff in the winter, bu it takes is an hour d south down Interstat to get back into wa golfable weather.

Plumas County, Calif.

LOCATED IN NORTHEASTERN CALIFORNIA, WHERE Sierra Nevada and Cascade mountain ranges m Plumas County has more than 100 lakes, and 1, miles of rivers and streams with more than a mil acres of national forest. Retirees, starting to disc this area in greater numbers, describe Pluma Lake Tahoe without the traffic. It's 90 miles f South Lake Tahoe and roughly an hour from R but far from either in terms of congestion. It's s and idyllic, and is rapidly expanding its golf opti

At the top of the list is Whitehawk Ranch Club (4½ stars, *Golf Digest's Best Places to Play*) the town of Graeagle. This mountainside co designed by Dick Bailey, is a hot spot for potentia tirees, not just for the scenery and quality of golf also for home values. Northern California real es is among the highest in the nation, but a three-l room house on the golf course at Whitehawk wa cently listed at $569,000. The only private club i area—Grizzly Ranch in Portola—is also growin popularity. Architect Bob Cupp designed the co in a valley alongside the surrounding mount There are a few other public courses in the are well, including Plumas Pines Golf Resort (3½ st Less than an hour away in Truckee, Calif., whic the gateway to the Tahoe/Reno region, is Laho Golf Club (No. 15 in California), a private course, Coyote Moon, an excellent public course. ■

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IMPORTANT SAFETY INFORMATION: LUNESTA works quickly, and should be taken right before bed. Be sure you have at least eight hours to devote to sleep before becoming active. Until you know how you'll react to prescription LUNESTA, you should not drive or operate machinery. Do not use alcohol while taking LUNESTA. Most sleep medicines carry some risk of dependency. Side effects may include unpleasant taste, headache, drowsiness and dizziness. See important patient information on the next page.

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1, 2 AND 3 MG TABLETS

Please read this summary of information about LUNESTA before you talk to your doctor or start using LUNESTA. It is not meant to take the place of your doctor's instructions. If you have any questions about LUNESTA tablets, be sure to ask your doctor or pharmacist.

LUNESTA is used to treat different types of sleep problems, such as difficulty in falling asleep, difficulty in maintaining sleep during the night, and waking up too early in the morning. Most people with insomnia have more than one of these problems. You should take LUNESTA immediately before going to bed because of the risk of falling.

LUNESTA belongs to a group of medicines known as "hypnotics" or, simply, sleep medicines. There are many different sleep medicines available to help people sleep better. Insomnia is often transient and intermittent. It usually requires treatment for only a short time, usually 7 to 10 days up to 2 weeks. If your insomnia does not improve after 7 to 10 days of treatment, see your doctor, because it may be a sign of an underlying condition. Some people have chronic sleep problems that may require more prolonged use of sleep medicine. However, you should not use these medicines for long periods without talking with your doctor about the risks and benefits of prolonged use.

Side Effects

All medicines have side effects. The most common side effects of sleep medicines are:

- Drowsiness
- Dizziness
- Lightheadedness
- Difficulty with coordination

Sleep medicines can make you sleepy during the day. How drowsy you feel depends upon how your body reacts to the medicine, which sleep medicine you are taking, and how large a dose your doctor has prescribed. Daytime drowsiness is best avoided by taking the lowest dose possible that will still help you sleep at night. Your doctor will work with you to find the dose of LUNESTA that is best for you. Some people taking LUNESTA have reported next-day sleepiness.

To manage these side effects while you are taking this medicine:

- When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
- Do not drink alcohol when you are taking LUNESTA or any sleep medicine. Alcohol can increase the side effects of LUNESTA or any other sleep medicine.
- Do not take any other medicines without asking your doctor first. This includes medicines you can buy without a prescription. Some medicines can cause drowsiness and are best avoided while taking LUNESTA.
- Always take the exact dose of LUNESTA prescribed by your doctor. Never change your dose without talking to your doctor first.

Special Concerns

There are some special problems that may occur while taking sleep medicines.

Memory Problems

Sleep medicines may cause a special type of memory loss or "amnesia." When this occurs, a person may not remember what has happened for several hours after taking the medicine. This is usually not a problem since most people fall asleep after taking the medicine. Memory loss can be a problem, however, when sleep medicines are taken while traveling, such as during an airplane flight and the person wakes up before the effect of the medicine is gone. This has been called "traveler's amnesia." Memory problems have been reported rarely by patients taking LUNESTA in clinical studies. In most cases, memory problems can be avoided if you take LUNESTA only when you are able to get a full night of sleep before you need to be active again. Be sure to talk to your doctor if you think you are having memory problems.

Tolerance

When sleep medicines are used every night for more than a few weeks, they may lose their effectiveness in helping you sleep. This is known as "tolerance." Development of tolerance to LUNESTA was not observed in a clinical study of 6 months' duration. Insomnia is often transient and intermittent, and prolonged use of sleep medicines is generally not necessary. Some people, though, have chronic sleep problems that may require more prolonged use of sleep medicine. If your sleep problems continue, consult your doctor, who will determine whether other measures are needed to overcome your sleep problems.

Dependence

Sleep medicines can cause dependence in some people, especially when these medicines are used regularly for longer than a few weeks or at high doses. Dependence is the need to continue taking a medicine because stopping it is unpleasant.

When people develop dependence, stopping the medicine suddenly may cause unpleasant symptoms (see *Withdrawal* below). They may find they have to keep taking the medicine either at the prescribed dose or at increasing doses just to avoid withdrawal symptoms.

All people taking sleep medicines have some risk of becoming dependent on the medicine. However, people who have been dependent on alcohol or other drugs in the past may have a higher chance of becoming addicted to sleep medicines. This possibility must be considered before using these medicines for more than a few weeks. If you have been addicted to alcohol or drugs in the past, it is important to tell your doctor before starting LUNESTA or any sleep medicine.

Withdrawal

Withdrawal symptoms may occur when sleep medicines are stopped suddenly after being used daily for a long time. In some cases, these symptoms can occur even if the medicine has been used for only a week or two. In mild cases, withdrawal symptoms may include unpleasant feelings. In more severe cases, abdominal and muscle cramps, vomiting, sweating, shakiness, and, rarely, seizures may occur. These more severe withdrawal symptoms are very uncommon. Although withdrawal symptoms have not been observed in the relatively limited controlled trials experience with LUNESTA, there is, nevertheless, the risk of such events in association with the use of any sleep medicine.

Another problem that may occur when sleep medicines are stopped is known as "rebound insomnia." This means that a person may have more trouble sleeping the first few nights after the medicine is stopped than before starting the medicine. If you should experience rebound insomnia, do not get discouraged. This problem usually goes away on its own after 1 or 2 nights.

If you have been taking LUNESTA or any other sleep medicine for more than 1 or 2 weeks, do not stop taking it on your own. Always follow your doctor's directions.

Changes In Behavior And Thinking

Some people using sleep medicines have experienced unusual changes in their thinking and/or behavior. These effects are not common. However, they have included:

- More outgoing or aggressive behavior than normal
- Confusion
- Strange behavior
- Agitation
- Hallucinations
- Worsening of depression
- Suicidal thoughts

How often these effects occur depends on several factors, such as a person's general health, the use of other medicines, and which sleep medicine is being used. Clinical experience with LUNESTA suggests that it is rarely associated with these behavior changes.

It is also important to realize it is rarely clear whether these behavior changes are caused by the medicine, are caused by an illness, or have occurred on their own. In fact, sleep problems that do not improve may be due to illnesses that were present before the medicine was used. If you or your family notice any changes in your behavior, or if you have any unusual or disturbing thoughts, call your doctor immediately.

Pregnancy And Breastfeeding

Sleep medicines may cause sedation or other potential effects in the unborn baby when used during the last weeks of pregnancy. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, or if you become pregnant while taking LUNESTA.

In addition, a very small amount of LUNESTA may be present in breast milk after use of the medication. The effects of very small amounts of LUNESTA on an infant are not known; therefore, as with all other prescription sleep medicines, it is recommended that you not take LUNESTA if you are breastfeeding a baby.

Safe Use Of Sleep Medicines

To ensure the safe and effective use of LUNESTA or any other sleep medicine, you should observe the following cautions:

1. LUNESTA is a prescription medicine and should be used ONLY as directed by your doctor. Follow your doctor's instructions about how to take, when to take, and how long to take LUNESTA.
2. Never use LUNESTA or any other sleep medicine for longer than directed by your doctor.
3. If you notice any unusual and/or disturbing thoughts or behavior during treatment with LUNESTA or any other sleep medicine, contact your doctor.
4. Tell your doctor about any medicines you may be taking, including medicines you may buy without a prescription and herbal preparations. You should also tell your doctor if you drink alcohol. DO NOT use alcohol while taking LUNESTA or any other sleep medicine.
5. Do not take LUNESTA unless you are able to get 8 or more hours of sleep before you must be active again.
6. Do not increase the prescribed dose of LUNESTA or any other sleep medicine unless instructed by your doctor.
7. When you first start taking LUNESTA or any other sleep medicine, until you know whether the medicine will still have some effect on you the next day, use extreme care while doing anything that requires complete alertness, such as driving a car, operating machinery, or piloting an aircraft.
8. Be aware that you may have more sleeping problems the first night or two after stopping any sleep medicine.
9. Be sure to tell your doctor if you are pregnant, if you are planning to become pregnant, if you become pregnant, or if you are breastfeeding a baby while taking LUNESTA.
10. As with all prescription medicines, never share LUNESTA or any other sleep medicine with anyone else. Always store LUNESTA or any other sleep medicine in the original container and out of reach of children.
11. Be sure to tell your doctor if you suffer from depression.
12. LUNESTA works very quickly. You should only take LUNESTA immediately before going to bed.
13. For LUNESTA to work best, you should not take it with or immediately after a high-fat, heavy meal.
14. Some people, such as older adults (i.e., ages 65 and over) and people with liver disease, should start with the lower dose (1 mg) of LUNESTA. Your doctor may choose to start therapy at 2 mg. In general, adults under age 65 should be treated with 2 or 3 mg.
15. Each tablet is a single dose; do not crush or break the tablet.

Note: This summary provides important information about LUNESTA. If you would like more information, ask your doctor or pharmacist to let you read the Prescribing Information and then discuss it with him or her.

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SEPRACOR

Making the Grade

College towns can be great places to retire

By Mark Morrison

ANYBODY WATCHING RETIREMENT trends knows that college towns are top draws. Retirees and soon-to-be's are pouring in, attracted by the diversity, energy, culture, sports, and employment opportunities that universities generate. You can get all these advantages plus some great golf choices in many college locales.

AUSTIN, WITH ITS THRIVING NIGHTLIFE, STRONG GOLF COURSES, AND UNIVERSITY CULTURE, IS A HAVEN FOR RETIREES

To identify the best spots, we asked the Longitudes Group to crunch the numbers. It found more than 20 college towns with at least four quality private and public courses. Among them were predictable venues like Raleigh-Durham-Chapel Hill (Duke, University of North Carolina), Eugene (University of Oregon), and Boulder (University of Colorado). It also identified some less obvious towns (table, page 106) such as Ann Arbor (University of Michigan).

At the top of the list is Austin, home of the University of Texas main campus. With the draw of a giant academic enterprise (45,000-plus students) and 11 top-quality golf courses and dozens more next-tier tracks, West Austin and the Hill Country are attracting thousands of retirees and second-home buyers. Michael and Kathy Poehl (pronounced "pell") are typical of the wave of newcomers. The Poehls lived and traveled all over the country as Mike, a chemical engineer, rose through the ranks at Amoco to plant manager and national sales manager. After looking in Colorado, South Carolina, and Florida, they retired in 2002 to Austin.

"For me, golf was going to be a central part of retirement, so I wanted to be in a place where the golf at all levels is superb," says Mike, 55, a 9-handicapper at Barton Creek Country Club, which offers four courses, two of them Tom Fazio-designed. Kathy is not a golfer, but she loves the theater, the arts, and being plugged into the campus. The move also has been a homecoming for Mike, who got his undergraduate degree at UT, and Kathy, who graduated from Texas State University, just 30 miles south.

If you have any doubts that a college environment might energize your retirement, follow Mike around for a few days and see him incorporate three or four rounds of golf every week amid his many other pursuits. He finds plenty of competition among fellow members at Barton Creek. And he plays in at least a dozen area tournaments each year. He also teaches two courses as an adjunct professor of chemical engineering at UT, attends almost every Longhorn home football and basketball game, and is helping launch a food-products company in nearby San Antonio.

In college towns, a connection with the university helps marketers appeal to future retirees. In Austin, for example, the giant Steiner Ranch development 30 minutes west of campus made a deal with the school to create the University of Texas Golf Club, a 7,225-yard Bechtol Russell layout that is home to the Longhorn golf teams. "We're signing a lot of young local members, but als high number who plan to retir the Austin area in the next dec or two," says membership dire Dana DeLorenzo. She estimates n than 100 nonresidents have joi at half the full initiation fee (ab to be bumped by almost 10% $30,000) with retirement plan mind. Just as the Barton Creek named legendary UT football co Darrell Royal (three national ch pionships) as its chairman, the Golf Club nabbed as its chair Mack Brown, coac the 2005 national-champion 'Horns.

IN AUSTIN, POEHL IS ABLE TO TEACH AT UT AND PLAY IN A DOZEN AREA TOURNEYS A YEAR

More than 60 universities are associated with tirement communities. In Palo Alto, Calif., for ex ple, the 388-unit Classic Residence by Hyatt sits a cent to the Stanford campus on land leased from university close to its storied golf course. "It's b fun to be able to play at Stanford and stimulatin live in a place wh you get a chance meet and dine w fascinating pe drawn from all the world," says torney Frank (San Tatum, who won NCAA Champions in 1942 while at St ford and later beca president of the Golf Assn. Tho some of his fel residents are Stanford alumni, many were attrac to the residence by its highly educated and afflu demographic.

In Austin, similar residences are going up at B ton Creek, where Royal will live and serve as vi chairman of the Querencia residence, with 168 u opening in 2007. The Ex-Students' Association the University of Texas and CRSA, a Memphis-ba operator, plans to develop Longhorn Village, a $ million senior residence affiliated with the Ex-S dents and located near the UT Golf Club. The Vill will offer residents continuing education in univer courses and shuttles to performing arts events campus. It's clear that golf and the university cult both will be central to their retirement lifestyle. ■

College towns with great golf

TOWN	COLLEGE	(NO. OF HIGH-QUALITY GOLF VENUES)
AUSTIN (WEST AUSTIN-TEXAS HILL COUNTRY)	University of Texas	(11)
ANN ARBOR	University of Michigan	(10)
MADISON	University of Wisconsin	(10)
FORT COLLINS	Colorado State University	(8)
EUGENE	University of Oregon	(5)
RALEIGH-DURHAM-CHAPEL HILL	Duke University, Univ. of N. Carolina	(4)
SANTA CRUZ	University of California-Santa Cruz	(3)

Data: Longitudes Group

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A Piece of the Action

»Collecting artifacts from the game's long history

By Mark Hyman

SOME PEOPLE COLLECT PAINTINGS. ANDY Kowalczyk collects jackets. Not just any jackets. The sport coats Kowalczyk covets are electric green, have the same number of buttons (two each sleeve, three center), and a distinctive patch over the left breast. They share one other feature: They're the signature jackets of Augusta National Golf Club.

Kowalczyk owns two of these items, which belonged to former club members, along with a 68-year-old plaque awarded to 1938 Masters champion Henry Picard and dozens of other sought-after relics of the golf world. His total investment easily runs into six figures, but money isn't the point. "I view my collection as an investment, but not purely 'buy low, sell high.' There's a lot of emotion tied up in golf and its history," he s

KOWALCZYK (ABOVE) OWNS TWO GREEN JACKETS. SCORECARDS (BELOW) SIGNED BY MASTERS CHAMPIONS

Few collectors of golf memorabilia have go rich off the hobby lately. The market for once-hig prized items such as 18th-century "long-no woods and 19th-century "feather balls" has fa considerably after spiking in the 1990s. A long-r wood that sold for about $500 in the 1970s $10,000 in the '90s might fetch $7,500, says R Jerris, the U.S. Golf Assn.'s director of r seum and archives. "In some cases, pr are down 50% from three or four ye ago," says Jerris, who cites the withdra of Japanese investors and the onset of a r generation of collectors that hasn't sho the same level of interest in high-end collectibles as aging predecessors.

Artifacts tied to the game's greatest p ers such as Bobby Jones, Harry Vardon,

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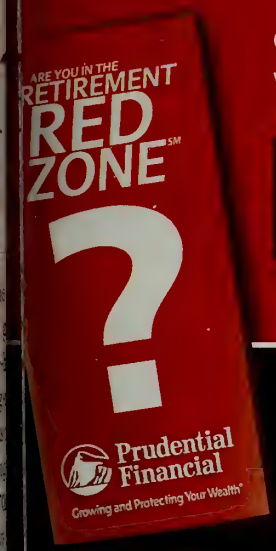

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LONG NOSE
A LONG SPOON FROM ABOUT 1840, WHEN CLUBMAKERS BEGAN TO THINK ABOUT LOWER SCORES

SQUARE-TOE IRON
THESE RARE 18TH-CENTURY CLUBS CAN FETCH MORE THAN $100,000

Jack Nicklaus have held their value. So have many rare golf books, according to Jerris. A first edition of *The Goff*, an 18th-century Scottish golf pamphlet thought to be among the first published writing about the sport, sells for $50,000 or more.

In any case, golf has a longer history than football, basketball, and NASCAR combined, and that alone makes it fertile ground for collectors. It also generates lots of stuff, from centuries-old clubs and balls to more affordable scorecards. Just make sure you know what you're buying. To avoid counterfeited or misrepresented items, do business with reputable dealers and established collectors.

NO CASUAL WATER
THE ROY WATER IRON, CIRCA 1879, WAS MEANT TO AVOID PENALTY STROKES. IT SOLD FOR $20,000 IN 1992

A Round with Tiger

A GOOD WAY TO START A COLLECTION IS TO LATCH onto a relatively narrow category. "If it's clubs, focus on clubs made before 1900, or a collection of just putters," says Karen Bednarski, executive director of the Golf Collectors Society (golfcollectors.com), whose 1,400 members snap up everything from Western Open memorabilia to photographs of Old Tom Morris, the Tiger Woods of the 1860s.

Oak Harbor (Wash.) dealer Jeffrey Ellis, 54, began his collecting obsession in 1974 after he bought 75 antique wooden-shaft clubs out of a barrel at a Goodwill store in Milwaukee. He now keeps a personal museum of more than 700 antique clubs, including two "square-toe" irons from the 1700s, each valued at more than $100,000.

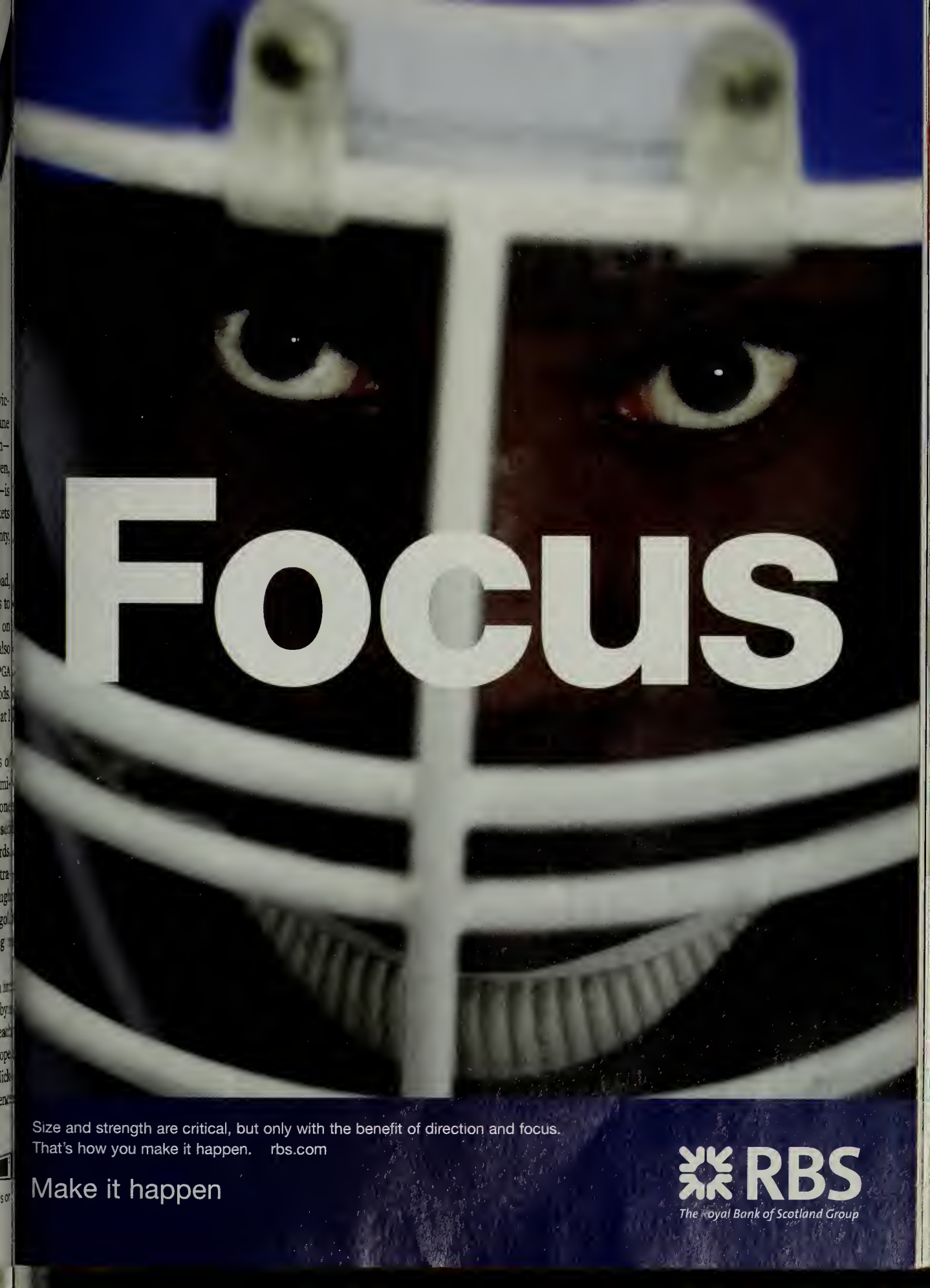
Kowalczyk was in his early 40s when he started bidding on items listed by major sports auction houses, including Leland's and Mastro Auctions Inc. The Picard plaque is the first major piece he acquired and remains one of his favorites. Later, he added another gem: Payne Stewart's handwritten entry to the 1999 U.S. Open, the final major championship victory of Stewart's career. Stewart died in a plane crash later that year. That one-of-a-kind item—valued at $1,500 to $3,000 by Brian Marren, vice-president for acquisitions at MastroNet—is displayed with one of the Augusta National jackets at Trump National Golf Club in Westchester County, N.Y., where Kowalczyk is a member.

Kowalczyk enjoys taking his collection on the road and when he does, he says, good fortune seems to follow. Kowalczyk put one of his Masters jackets on display at the Doral resort in Miami, where he is also a member. In 2002 he entered the pro-am to the PGA Tour stop at Doral, and was paired with Tiger Woods. "They said it was a blind drawing, but the fact that I had the jacket there may have helped," he says.

You don't have to invest tens of thousands of dollars to be a collector, or even to become a minor legend in golfiana circles. Russ Glasson is one of just three collectors estimated to have amassed more than 100,000 pocket-size golf scorecards. Glasson, 70, a retired purchasing administration manager, acquires most of his cards through trades and by requesting new ones from golf courses around the world—always enclosing a self-addressed, stamped envelope.

The most valuable cards in Glasson's collection are the 40 or so from Augusta National, each signed by a Masters champion. Glasson sends the cards to each new Masters winner and then waits for an envelope. "It took two years to get one back from Jack Nicklaus," he says, proving that ingenuity and patience pay off in the golf collecting game. ■

BusinessWeek weekend To see the incredible collection of one Tiger Woods fanatic, watch our TV show, *BusinessWeek Weekend*. Check local TV listings or go to businessweekweekend.com for video clips.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No Gimmes

»A passion for the game is no guarantee of success in the golf industry By Dean Foust

WHEN IT COMES TO BUSINESS, MIKE Bonneau has found success in virtually every venture he has entered. In the 1980s, Bonneau patented several designs for a coronary stent and made a small fortune when he sold the rights to medical-device giant Medtronic Inc. In the years since, the 54-year-old entrepreneur has made a nice living in Silicon Valley as the owner of an outfit that makes precision-machined parts for the semiconducto industry. But the admitted golf nut has experienced only heartache and frustration since starting a company to sell a line of putters he designed. Fou years after launching Aserta Sports Inc., Bonneau says he hasn't sold enough of the putters to cove his hefty expenses, which include $3.5 million fo advertising alone. Asked if he'd do it all again, h doesn't hesitate. "Probably not," he says. "It's to

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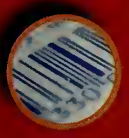

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expensive to market products in the golf industry. I just don't know if I have a lot of good things to say about the golf business."

Bonneau isn't alone. Eager to indulge their passion for the game they love, more and more business executives have jumped into the golf business in recent years—all harboring dreams of becoming the next Ely Callaway, who launched the wildly successful Callaway Golf Co. after a long career as president of Burlington Industries Inc. But many of these aspiring golf moguls have discovered the hard way that there's only one Ely Callaway, and that replicating his success is tougher than they imagined. Rudy Slucker can attest to that. Four years after acquiring the TearDrop, Tommy Armour, and ram lines of golf equipment—troubled brands that he hoped to turn around—the former hardware magnate was forced to sell them in a 2001 bankruptcy auction. Ditto for leveraged buyout kings (and avid golfers) Henry Kravis and George Roberts, who bought the venerable Spalding brand in 1996 for $370 million only to sell it in a bankruptcy auction seven years later for less than half that amount. (A spokesperson for Kravis' firm noted that the firm did extremely well in a golf resort venture; efforts to reach Slucker were unsuccessful.)

WITHOUT AN ENDORSEMENT FROM A PGA TOUR PLAYER, SALES OF MIKE BONNEAU'S PUTTER HAVE BEEN DISAPPOINTING

Those entrepreneurs who try to bring back an iconic brand find that's not easy either. Ask Barry Schneider, who bought MacGregor Golf Co. in 1998. Schneider should know how to revive a business: After taking charge of his family's small flooring-installation business in 1977, Schneider turned it into a $300 million company employing 2,000 workers in 31 states. Yet eight years after Schneider acquired MacGregor, the venerable clubmaker still has less than a 1% share of the market for woods, irons, wedges, and putters. Schneider remains optimistic that his investment will eventually pay off—so much so that in late October he acquired the Greg Norman Collection apparel line, and brought Norman in as a major investor in MacGregor. "While we're relatively small in the U.S., the innovation is everything that I hoped for," he says.

Why is it so hard for business executives to replicate in the golf business the success they've achieved in other fields? The tough golf environment doesn't help. With retail sales of equipment flat for several years, newcomers must steal market share from entrenched players such as Titleist and TaylorMade Golf Co. Recent U.S. Golf Assn. restrictions on equipment specs don't help either: The current generation of entrepreneurs can't differentiate their product as Callaway did, when he introduced a driver that was nearly a third bigger than everyone else's. On the other hand, some of the would-be tycoons have only themselves to blame for their lack of success. Industry watchers say some neophytes get into the business for the wrong reason—namely, to rub elbows with pga Tour pros—and then learn an expensive lesson on the golf business. "A lot of these executives achieve financial security, but now they want fame," notes Gene Parente, who as owner of an equipment-testing company, Golf Laboratories Inc., has worked with scores of wannabe golf moguls over the past 17 years. "I've seen executives who call me all excited and say, 'I'm staying at Arnold Palmer's house.' They cease to be dispassionate about the business."

A number of entrepreneurs admit they underestimated how tough it is to crack the golf business. Consider the plight of Dick

DEEP IN THE ROUGH

Why the golf biz can be inhospitable to newcomers

SO MANY SHOPS, SO LITTLE... Unlike other industries, where having a couple of large customers can guarantee success, golf is fragmented, with thousands of small retailers and country clubs that must be marketed to individually.

NO GROWTH Tigermania resulted in booming sales in the 1990s, but in recent years industry sales of equipment have been flat. To grow, new entrants now have to steal market share from established brands such as Callaway, Ping, and TaylorMade.

REGULATORY CONSTRAINTS Ely Callaway took the industry by storm in the 1990s by selling a driver that was larger than anything on the market. But in recent years the USGA has begun imposing tighter restrictions on equipment—making it harder for newcomers to differentiate their products.

BIDDING WARS FOR STARS
Today's tour pros are more mindful of their endorsement value, making it harder for small equipment makers to find pros who will play their gear for free.

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AFTER EIGHT YEARS, SCHNEIDER'S GOAL OF REVIVING MACGREGOR IS STILL A WORK IN PROGRESS

Eyestone. A former executive vice-president of Bay Networks Inc. in Silicon Valley, Eyestone cashed out during the dot-com boom in the late 1990s at age 52, perfectly content to spend the rest of his years playing lots of golf. But frustrated over his inability to get his handicap below 15—and exasperated that lessons didn't help—Eyestone used his knowledge of technology to develop a club that would help him analyze his swing. The result: a driver with special circuitry built into the shaft that allowed users to record and, with software, later see the exact arc of each swing they took on the course or range. After lining up outside investors, Eyestone began marketing his SmartSwing driver to teaching pros, who he hoped would incorporate SmartSwing into their lessons and then sell the club to students. To his chagrin, Eyestone sold only 300 of his high-tech clubs over the next two years, prompting him to close SmartSwing last January after suffering what he will only say were "considerable" losses. "We had Top 100 teaching pros look at this and say, 'I could really use this,' but we couldn't get anybody to commit," he says. "We really needed to go direct to the consumer, but the cost of an infommercial was prohibitive."

Pay to Play

INDUSTRY INSIDERS SAY EYESTONE MIGHT HAVE OVERestimated the willingness of teaching pros—like golfers themselves, a relatively conservative bunch—to embrace an unproven product. "The golf industry is very slow to adopt new technology," says Chris Hart, chief executive of Interactive Frontiers Inc., which bought the rights to Eyestone's technology. "It takes a lot of work to convince golf pros, if they've already got a routine that works." Eyestone admits he might have overestimated the desire, if not the ability, of instructors to sell his clubs to their students. "They're teaching pros, not salesmen."

For many entrepreneurs, the best route to success can be simply to convince a top tour pro to play their club. After Nick Price used a putter designed by Bobby Grace to win the 1994 pga Championship, Grace was deluged with 27,000 orders on Monday morning. But small clubmakers complain that the majority of today's pga Tour pros, more mindful of their endorsement value, are less willing to play clubs without some form of compensation. Bonneau claims he was approached by several pga Tour pros—he would not name names—who told him they loved his putter enough to play it on tour. Bonneau just had to match the endorsement money being offered by other clubmakers, which in many cases was $100,000 or more, a demand he says he couldn't afford.

Then again, when entrepreneurs do spend the dollars for endorsements, they find that's no guarantee of success. Bruce Burrows, who made a fortune with the Oasis water-cooler business, spent millions to gain Champions Tour endorsements from the likes of Ben Crenshaw and Bruce Lietzke for his unique line of drivers, only to fold his business after a few years when sales didn't materialize. "I don't think the Champions Tour endorsements resonated," says George Montgomery, a former president of TaylorMade and a friend of Burrows. Golf industry insiders say they caution newcomers about getting into the game, given the low odds of success. "The business is flat, the costs of manufacturing are increasing, and sales prices are decreasing—why would anybody get into this business?" asks Barney Adams, the founder of Adams Golf Inc. But even Adams admits there's a magnetic pull to golf that will continue to draw new entrants. "As I speak, I guarantee there are 500 fairly successful people in the U.S. getting ready to get into the golf business. It's an intoxicating game." ■

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CLARKE, WITH MOM, ALISON, CADDIEING, AT THE NEW YORK STATE MID-AMATEUR IN SEPTEMBER

Championship Résumés

›› Hitting fairways, sinking putts, and bringing in business

By Mark Hyman

MATTHEW CLARKE LEADS A DOUBLE LIFE. He's president of Bouchey & Clarke Benefits Inc. in Troy, N.Y., an advisory firm that helps companies choose employee-benefits plans. In his spare time, Clarke also is among the best amateur golfers in upstate New York.

The two identities might seem to have no connection. But Clarke knows otherwise. "In business, people tend to gravitate to golfers for some reason. Golf is a game a lot of people aspire to play well. I wouldn't call myself a celebrity by any means. But the exposure is always helpful," he says.

Each year, U.S. Golf Assn. championships attract a few dozen business execs with stellar games trying to add national tourney victories to their résumés. Business types most often make their appearances in the U.S. Mid-Amateur championship, for players 25 years and older, and the USGA Senior Amateur, for golfers who have reached their 55th birthday. (The U.S. Senior Women's Amateur is for players 50 and over.) This year the lineup in these championships included a restaurant owner from Connorsville, Ind., a steel company exec from Canada, and the

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Clarke, 45, played in September's Mid-Amateur in Flagstaff, Ariz., his seventh USGA event. (His best showing is a round-of-16 finish at the 1999 Mid-Amateur.) Paul Simson, president of Stan Taylor Insurance, of Raleigh, N.C., carried the flag of property and casualty agents in this year's U.S. Senior Amateur. Simson, 55, nearly swept the senior amateur titles this season. After winning the British Senior Amateur in August, Simson forged into the quarterfinals before being defeated in the U.S. Senior Amateur in September.

CLARKE'S REPUTATION AS A TOP-NOTCH PLAYER GIVES HIM AN INSIDE TRACK IN BUSINESS

JAY SIGEL TURNED PRO AT 50—HE NOW HAS EIGHT CHAMPIONS TOUR VICTORIES

Creating Opportunities

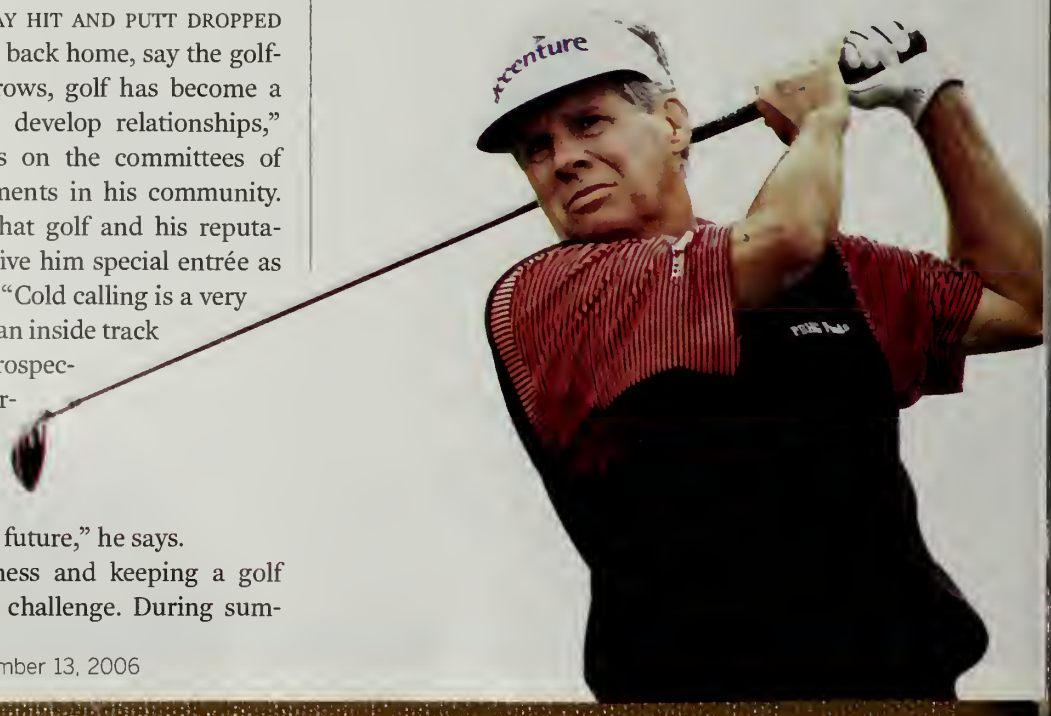
IN A SENSE, EVERY FAIRWAY HIT AND PUTT DROPPED is a boon to the business back home, say the golfers. "As my business grows, golf has become a more important way to develop relationships," says Clarke, who serves on the committees of five charity golf tournaments in his community. Simson agrees, saying that golf and his reputation as a strong player give him special entrée as he solicits new business. "Cold calling is a very difficult process. Having an inside track is very helpful. Even if [prospective clients] are not interested in switching business, you've started a conversation that might create opportunity in the future," he says.

Still, running a business and keeping a golf game sharp is no small challenge. During summer months, Clarke, a former Division III nationa champion at Allegheny College, usually starts o ends his day with something golf-related. In th morning, he often stretches or runs. In the eve ning, he reaches for a golf club, if only to get in 1 minutes of putting practice after work.

Giving up on championship golf isn't an op tion he'd seriously consider, Clarke says. "I hav an internal need for competition, and I've alway loved to compete in golf. It's become part of my M as a business person, too." Playing top-level ama teur golf is an expensive habit. With his Europea travel and other tournaments, Simson estimate his golf tab this year totaled $20,000 to $25,000 But the reigning British Amateur champion jokes "I did get my money's worth this season."

Sometimes a businessman who plays golf on th side turns the sport into a second profession. Whe Berwyn (Pa.) insurance exec Jay Sigel reached hi 50th birthday in 1993, he turned pro and joined th Champions (then Senior) Tour, leaving behind stellar career that included two U.S. Amateur title and one British Amateur championship. In his firs five years as a pro, Sigel won six tournaments an earned almost $5 million.

To this day, Sigel continues to sell policies and ser vice clients. In addition to playing on the Champion Tour, he is senior vice-president of Cbiz Inc., a pub licly traded insurance group. He has been introduce to countless clients on the golf course, but says h tries not to rely on his stature in the game. "I've neve thought anyone should do business with me becaus I play golf," he says. "I don't go to my barber becaus he's a good fisherman—and I like to fish." ■



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Mike Mallett returned to Ohio to raise his family and build a $10 million "Mystery" business.

Mike has moved his growing company into a 100-year old, former warehouse with plenty of room to expand. An avid golfer and memorabilia collector, Mike also was able to purchase his own golf course. It's a public course, but he can *always* get a tee time.

MIKE MALLETT'S STORY

"I was successful in D.C. But I found that Ohio offered everything I wanted for my business and my family."

Mike Mallett, President and CEO
Corporate Research International

After leaving the University of Findlay in the mid-80's, Mike Mallett found business success in Washington, D.C. But when he and his wife, Anne, started a family, they knew where they wanted to be: back in Ohio, where right–sized cities offer all the amenities of a metropolis at a simpler, relaxed pace.

In Ohio's fertile business environment, Mike founded Corporate Research International (CRI), now one of America's foremost 'Mystery Shopper' Research firms with clients that include many of the world's leading retailers, restaurants and petroleum companies. In Ohio, Mike has found the intelligent, affordable work-force he needs, and Ohio's "At Will" employment laws help him choose the best. Low overhead and CRI's ability to develop technology well ahead of the competition has helped place CRI on *Inc.* magazine's list of fastest-growing companies two years running.

In a setting one client describes as a Norman Rockwell painting, Mike can manage this $10 million company and still make the four-minute trip to pick up his kids for soccer. Or drive an hour to their Lake Erie beach house to ski and fish and enjoy a summer sunset on the beach. Mike can't imagine working — or living — anywhere else.

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BY ROBERT PARKER

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"MOLLYDOOKER" IS THE AUSSIE TERM FOR LEFTY, and it's an apt name for the wines produced in South Australia by the husband-and-wife team of Sparky and Sara Marquis. They're both southpaws, as are most of their staff. While the winery's name and labels are playful, what's in the bottle is serious: finely crafted, superconcentrated wines. Count these cuvées among the so-called Australian fruit bombs, wines often reviled by elitist, Eurocentric oenophiles simply because they taste too good too soon.

2006 The Violinist

92 points. This gorgeous, dry, full-bodied white (100% verdelho; 1,300 cases produced) was fermented and aged in both new and old French and American oak, then bottled early. It boasts notes of honeyed melons and other tropical fruits, beeswax, and crisp citrus, along with good underlying acidity, an explosively rich mid-palate, and a fresh, creamy texture and finish. Enjoy it during its first year. $15

2005 The Boxer

95 points. This shiraz cuvée exhibits a black/blue/purple color, an incredible density of fruit, and pure blackberry, white flower, melted chocolate, sweet licorice, and subtle wood notes. Full-bodied, beautifully layered, and with an awesome finish, it should drink well for four to six years or more. $20

2005 Two Left Feet

94 points. A blend of 65% shiraz, 19% merlot, and 16% cabernet sauvignon, this wine is aged for 9 to 12 months in American and French oak (half new, half year-old). It has an inky purple color, a sweet, full-bodied nose of crème de cassis, graphite, white chocolate, black olives, blackberry liqueur, and spice, and a spectacular, even unctuous texture. Drink it over the next three to four years, although it should last for a decade or longer. $20

2005 The Maitre D'

92 points. A superb cabernet sauvignon aged in a combination of American and French oak (40% new), this wine offers a crème de cassis note intermixed with hints of licorice, new wood, and spice box. The wine is full-bodied, with great intensity, purity, density, and opulence, as well as a rich mid-palate and long, supple finish displaying notions of roasted coffee and white chocolate. It's hard to believe that cab can hit this quality at this price. It is meant to be consumed young but should last for 5 to 10 years. $20

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin board, tens of thousands of tasting notes, or to order his recent book, *The World's Greatest Wine Estates: A Modern Perspective.* You can also subscribe to Parker's newsletter, *The Wine Advocate.* Request a sample copy at: *The Wine Advocate,* P.O. Box 311, Monkton, MD 21111.

2005 Carnival of Love

99 points. A selection of the finest shiraz barrels, this beauty boasts an extraordina black/purple color, gorgeous notes of blackberry liqueur, camphor, and smoke, and an enormous voluptuousness. There's great purity and harmony for such a rich, intense wine. As it sits in the glass, espres vanillin, white chocolate, and additional black fruits emerge. It should drink well fo decade. $60

2005 Enchanted Path

96 points. A mix of 66% shiraz and 34% cabernet sauvignon aged primarily in American oak (60% new), this cuvée revea an opaque purple/blue/black color; a full-bodied, smoky nose; layers of fruit, spice, and glycerin; plus full body, superb intensit and tremendous richness. It should age beautifully for 10 to 15 years. $60

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/ext

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Fixed Income at Your Fingertips

E-brokers are cutting trading costs and offering better pricing data and analytical tools for millions of bond issues. **BY LEWIS BRAHAM**

PEOPLE BUY STOCKS TO GET RICH and bonds to stay rich. Or so the saying goes. Is it any wonder, then, that online brokers have traditionally cared more about equity investors? Stock owners make far more trades and throw off far more in commissions than bond buyers. So for Web brokers, bonds were an afterthought.

Until now. A number of e-brokers have quietly built effective trading services for bonds, offering better technology, novel research tools, larger inventories, and more transparent pricing. This is no mean feat. Unlike stocks, most bonds trade infrequently, if at all, and may be available only at certain dealers. Moreover, there are some 4 million bond issues extant and often precious little information about individual ones. That compares with about 10,000 U.S. stocks, many of which are tracked incessantly by analysts.

Other e-brokers may be cheaper or offer more issues, but Fidelity Investments has the best technology for finding and analyzing bonds. "How do I get you the right information on, say, a particular bond of Ford Motor when Ford offers 1,700 unique bonds, each with a different maturity, price, and credit features? That was the challenge for us technologically," says Andrew Wrobel, Fidelity's senior vice-president for fixed-income products.

About half of the 10,000 bonds Fidelity offers every day come from the broker's trading desk. The others come from BondDesk Group, an electronic marketplace that consolidates bond dealers' inventories and prices and puts them online. Fidelity will flag a bond if it determines a dealer's price is too high or if the yield is excessive relative to the credit rating. "Often the credit ratings lag the news on a company," says Wrobel. "So if a General Motors bond is yielding 8% and is still rated BBB when BBB-rated bonds are only yielding 5% on average, we would flag that. The market is indicating that its credit quality may not be as good as its current rating suggests."

WATCH THE YIELDS

MOST BOND BROKERS allow you to screen for bonds based on maturity dates and credit quality, but they usually display the results as line items in a table. Fidelity's Scattergraph tool plots the results graphically along a yield curve, making it easier to spot bonds that yie more than comparable issues. Anoth tool provides detailed snapshots on tw bonds side by side, and the hypothetic trade feature allows you to see how bond purchase would affect your portf

WESLEY BEDROSIAN

BusinessWeek weekend For more on investing in bonds, watch our TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com to see video clips or to find out where the show airs in your area.

io. Fidelity is also the only e-broker that ffers historical price data on bonds.

Of course, gee-whiz technology means nothing if you can't get a good price. Traditionally, bond brokers have charged a narkup instead of a flat commission. So f a broker buys a bond from a dealer for, ay, a par value of 100 (in bond parlance, hat's a $1,000 bond), he might mark it up to 105, building in a $50 profit. The problem for investors: Because the commission is priced into the bond, you can't eparate out the markup.

Online brokers are starting to move away rom markups to a flat commission system, nuch like that on stocks. Fidelity charges $2 per corporate bond, $1.50 per municipal bond, and 50¢ per Treasury bond—or $19.95 per trade, whichever is greater. At Vanguard Brokerage Services, the price is $2 per corporate bond (with a $25 minimum), $5 per municipal bond with a $50 minimum, and 75¢ per Treasury bond with a $40 minimum. E*Trade Financial plans o shift to flat commission pricing for bonds by yearend, and Schwab is considering it.

Bonds for Less, a brokerage site run by Zions Bancorp of Salt Lake City, charges a flat $10.95 for bond trades. It's not quite as good as it sounds, though. Most of the bonds come from BondDesk, where markups from dealers are already priced in. So the $10.95 is on top of what BondDesk charged.

James Klotz, president of FMSbonds.com, an online municipal bond dealer that only offers bonds from its own inventory, is passionate about the distinction. "Anybody who says they can do a $50,000 bond trade for $10.95 is misleading you," he says. "They're selling you my bonds, and I already got a point and a half [$75] on the trade." Still, W. David Hemingway, executive vice-president at Zions in charge of Bonds for Less, notes that BondDesk's securities carry institutional markups, significantly lower than what individuals pay.

Buying Bonds Online

BROKER/WEB SITE	COMMENTS
BONDS FOR LESS zionsbank.com/zd_bonds_less.jsp	$10.95 per trade of any size. Offers about 10,000 bonds a day, most from BondDesk Group.
CHARLES SCHWAB schwab.com	No commission, but bonds are marked up. Wide selection of bonds—20,000 to 25,000 a day—half from own inventory.
E*TRADE etrade.com	Bonds are marked up, but plans to switch to commission-based sales; 25,000 bonds, most from BondDesk.
FIDELITY INVESTMENTS fidelity.com	$2 per corporate bond, $1.50 per muni, $0.50 per Treasury bond, with $19.95 minimum per trade. Excellent research and trading technology. Half of bonds from own inventory.
FMSBONDS fmsbonds.com	Only sells muni bonds, handling about 200 issues per day. Excellent advice online and by phone.
SHOP4BONDS shop4bonds.com	Charges 0.1% to 0.2% of yield, depending on maturity, with a $55 minimum per trade. Carries 45,000 bonds.
VANGUARD BROKERAGE SERVICES vanguard.com	Costs $2 per corporate bond, $5 per muni, and $0.75 per Treasury bond. Has minimum commissions.

FLUCTUATING MARKUPS

EVEN WITH MARKUPS, prices can be competitive. Schwab, which offers 20,000 to 25,000 bonds a day, half from inventory, says its prices compare to Fidelity's. "If a bond we've purchased for our inventory has rallied, we can offer it for a lower price than the average dealer," says Jim White, Schwab senior vice-president. Indeed, when we compared brokers, Schwab's markup for a General Electric Capital bond ranged from 50¢ to $1, beating Fidelity's $2 commission.

Also, you may decide it's worth paying a markup for a low-priced bond not available elsewhere. Shop4Bonds' site has 45,000 bonds; its markups range from 0.1% to 0.2% of a bond's yield. That generally means $4 to $8 a bond for high-rated corporates. "Chances are if a bond's available for sale, you'll find it here," says Jim Korth, managing partner.

Still, the only way to get the best deal is to comparison-shop. This can be simple with Treasuries, but finding two identical munis can be nearly impossible. So until every broker offers the same bonds for the same price, buying bonds will never be as easy as buying stocks. ■

BY GENE G. MARCIAL

WHY ONE STRATEGIST PICKS ANHEUSER-BUSCH AND ATHEROS.

CARTER'S IS UP AND WALKING, WITH OSHKOSH B'GOSH IN TOW.

WATCH FOR LICKETY-SPLIT NETWORK SPEEDS FROM LUMERA.

A Bear's-Eye View

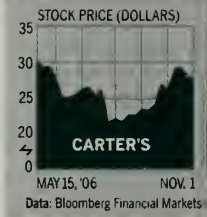
A GOOD DEFENSE is the best offense—even now, with the Dow Jones industrial average still hitting fresh highs. So argues Dawn Bennett, CEO of Bennett Group Financial Services, who has started beefing up her $700 million portfolio with stocks she thinks will ride out the volatility that may come from an economic downturn or even a geopolitical upheaval. Topping her "defensive" stocks: No. 1 brewer Anheuser-Busch (BUD) and Atheros Communications (ATHR), which makes semiconductors for wireless devices and infrastructure "systems-on-chips" for corporations. Both companies are cash-rich with little debt—and have firm grips on their markets, says Bennett. Atheros' sales rocketed from $1.8 million in 2001 to $183.5 million in 2005. They are expected to hit $300 million in 2006. Anton Wahlman of ThinkEquity Partners says a major stimulus for Atheros is the likelihood that a big chunk of the 1 billion cell phones sold annually will contain its chips. He rates Atheros, now at 20, a "buy," with a 12-month target of 29. For Anheuser, Bennett says global expansion is key for growth. It has a 50% share in the U.S. and 11.5% overseas. Anheuser is focusing on China, where it owns 27% of fast-selling Tsingtao beer. Bennett says the stock, now at 47, is worth 55. Even when the market turns bearish, which she believes is now happening, Anheuser and Atheros will thrive, she asserts.

DAWN BENNETT

Carter's Sews Up More Of the Kids' Apparel Market

WHEN CARTER'S (CRI), a leading maker of young children's quality apparel, fell to 21 in September after hitting 35 in March, Robert Olstein, president of investment firm Olstein & Associates, started buying in. Carter's missed its second-quarter profit estimates, but Olstein believes it will surprise the Street with earnings for all of 2006 of $1.50 a share, vs. a consensus estimate of $1.45. For 2007, the consensus figure is $1.75. It's possible, says Olstein, that Carter's could earn $2 in 2008-2009. The company has cut costs to the bone, he says, and its acquisition of Oshkosh B'Gosh in July, 2005, is boosting sales. He expects Carter's will nearly double its 340 stores nationwide, including Oshkosh's 143 outlets, to 600 in three years. Olstein figures the stock, now at 27, will hit 40 by 2008. Carter's also supplies high-quality but low-priced clothes to Target and Wal-Mart. R.J. Hottovy of Next Generation Equity Research, who rates Carter's a "buy," estimates 2006 sales of $1.34 billion, driven by further momentum in discount/mass-market sales and contributions from Oshkosh.

IT TOOK A LITTLE TUMBLE

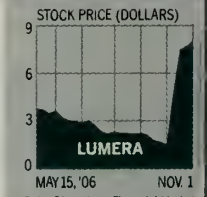


Data: Bloomberg Financial Markets

Lumera Lights Up —And Streaks Ahead

ONE OF THE BIGGEST winners on the NASDAQ in October was an obscure outfit called Lumera (LMRA). It rocketed from 1.58 on Friday, Oct. 13, to 5 on Monday, Oct. 16. By Oct. 24, it had jumped to 7.56. It has since gone up to 8.08. Part of the lightning rise was due to short-covering. The big crowd that had shorted it didn't expect such a blitzkrieg in just days. Is Lumera a mere flash in the pan? Don't count it out, "as it is certainly a stock to watch," says Bernie Schaeffer, CEO of Schaeffer's Investment Research. Lumera started to move after the electronics specialist said it completed successful testing of its "millimeter wave wireless bridge" that allows the transmission of "vast amounts of data via a variety of high-speed telecommunications networks." Lumera CEO Thomas Mino says it's an entirely new concept based on photonic technology: "Our vision is to make communications delivery faster than ever." With such a system, people will have access to video, data, and voice "at speeds and prices once unimaginable." The new system, says Mino, could download the data-equivalent of six DVDs in on minute. Lumera has also produced a "Proteomic Processor" biosensor that Harvard Medical School will use "to develop chemistry for drug discovery," says Mino. Short-covering, says Schaeffer, could fuel more rallies in the stock. ■

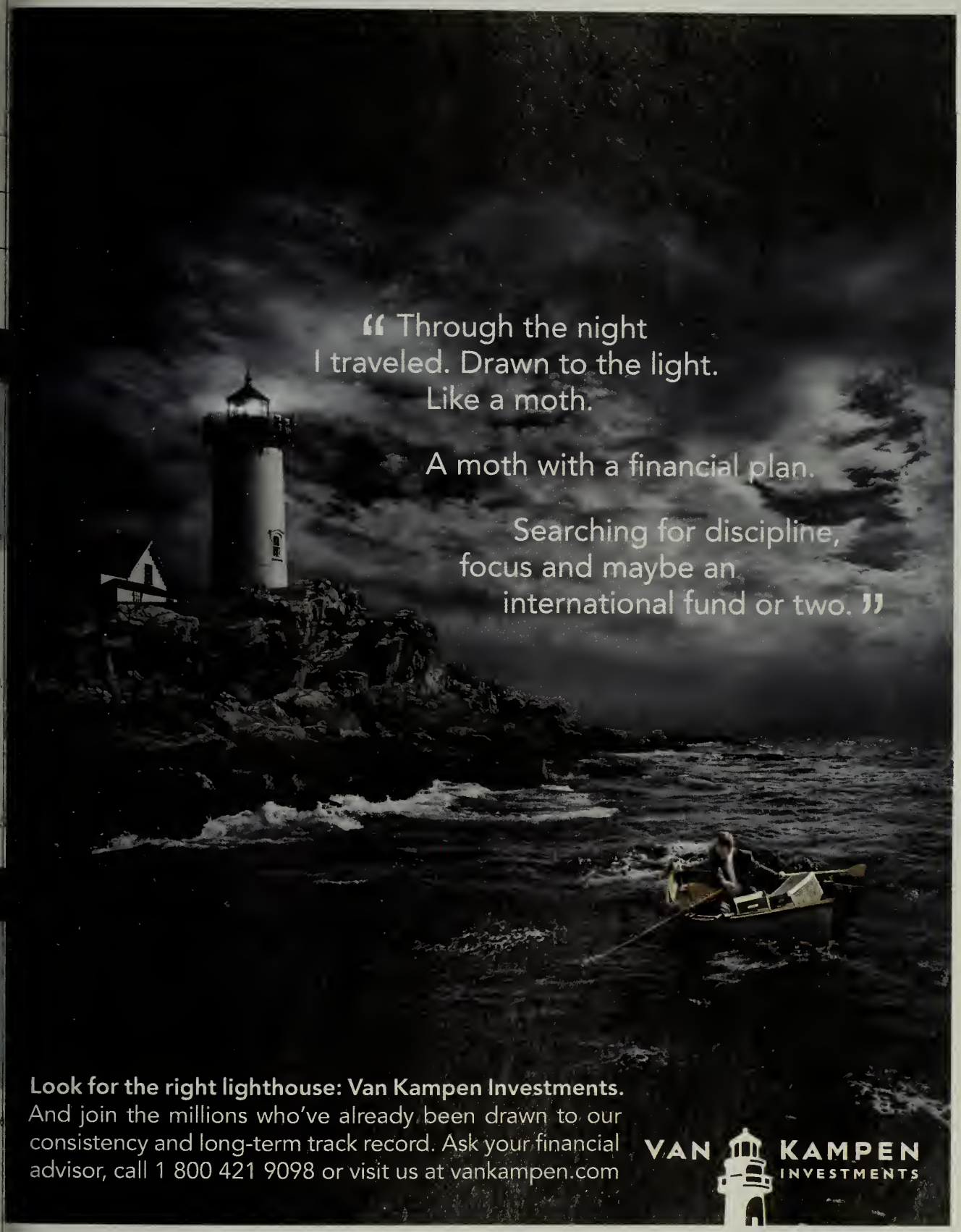
ZOOMING HIGHER



Data: Bloomberg Financial Markets

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.



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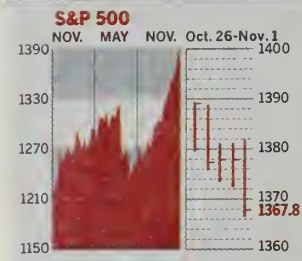
STOCKS



COMMENTARY

A string of softer-than-expected economic results pulled the Dow off its record highs. Word that CVS is going to buy Caremark Rx did not go over well; shares of the drugstore chain tumbled 7.4% and the pharmacy benefits manager fell 2.2% on Nov. 1. Meanwhile, American Power Conversion surged 28% for the week on news it will be bought by France's Schneider Electric.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	NOV. 1	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1367.8	-1.0	9.6	13.7
Dow Jones Industrials	12,031.0	-0.9	12.3	15.6
NASDAQ Composite	2334.4	-0.9	5.9	10.4
S&P MidCap 400	775.5	-1.8	5.1	10.7
S&P SmallCap 600	383.8	-2.1	9.4	13.5
DJ Wilshire 5000	13,673.2	-1.1	9.4	13.9

SECTORS

BusinessWeek 50*	770.9	-1.6	3.9	6.0
BW Info Tech 100**	428.4	0.4	12.6	18.5
S&P/Citigroup Growth	634.6	-1.0	6.4	10.5
S&P/Citigroup Value	731.1	-1.1	12.9	17.1
S&P Energy	426.2	-2.2	14.4	15.7
S&P Financials	472.2	-0.9	10.7	16.1
S&P REIT	192.7	0.2	25.9	31.9
S&P Transportation	266.3	-2.6	6.6	15.0
S&P Utilities	182.8	0.0	14.5	17.0
GSTI Internet	187.7	1.0	-8.5	0.1
PSE Technology	848.5	-0.5	1.4	6.4

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	NOV. 1	WEEK	% CHANGE YEAR TO DATE	% CHANGE LA MO
S&P Euro Plus (U.S. Dollar)	1863.0	1.3	23.2	
London (FT-SE 100)	6149.6	-1.0	9.4	
Paris (CAC 40)	5370.9	-0.9	13.9	
Frankfurt (DAX)	6291.9	0.4	16.3	
Tokyo (NIKKEI 225)	16,375.3	-1.9	1.6	
Hong Kong (Hang Seng)	18,453.7	1.6	24.0	
Toronto (S&P/TSX Composite)	12,050.4	-2.4	6.9	
Mexico City (IPC)	23,042.3	-1.5	29.4	

FUNDAMENTALS

	OCT. 31	WEEK AGO	YEA
S&P 500 Dividend Yield	1.78%	1.78%	2.0
S&P 500 P/E Ratio (Trailing 12 mos.)	17.5	17.8	17
S&P 500 P/E Ratio (Next 12 mos.)*	14.9	14.8	14
First Call Earnings Surprise*	6.01%	5.25%	1.2

*First Call

TECHNICAL INDICATORS

	OCT. 31	WEEK AGO	RE/
S&P 500 200-day average	1293.0	1290.7	Pos
Stocks above 200-day average	68.0%	67.0%	Ne
Options: Put/call ratio	0.82	0.86	Pos
Insiders: Vickers NYSE Sell/buy ratio	4.31	4.13	Nega

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Consumer Electronics	22.6	Steel	94.0
Steel	17.0	Divsfd. Metals & Mining	50.6
Internet Retailers	16.9	Agricultural Products	49.5
IT Consulting	16.8	Department Stores	44.9
Auto Parts & Equip.	13.7	Intgrd. Telecmms. Svcs.	39.1

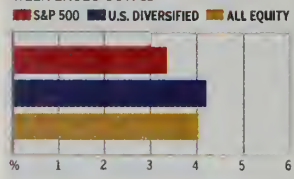
WORST-PERFORMING GROUPS

	LAST MONTH %		LA MOI
Education Services	-27.1	Education Services	-
Health-Care Services	-14.5	Homebuilding	-
Airlines	-10.4	Internet Software	-
Home Furnishings	-8.4	Spclzd. Cnsmr. Serv.	-
Drug Chains	-6.8	Internet Retailers	-

MUTUAL FUNDS

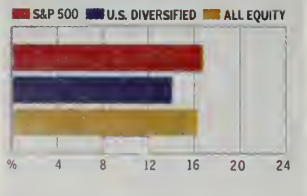
4-WEEK TOTAL RETURN

WEEK ENDED OCT. 31



52-WEEK TOTAL RETURN

WEEK ENDED OCT. 31



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	11.0	Precious Metals	49.9
Natural Resources	10.3	Latin America	38.9
Latin America	9.9	Real Estate	36.8
Small-cap Growth	6.3	Pacific/Asia ex-Japan	33.2
LAGGARDS		**LAGGARDS**	
Japan	0.8	Large-cap Growth	9.2
Financial	2.1	Health	9.5
Domestic Hybrid	2.4	Japan	10.4
International Hybrid	2.6	Technology	10.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
DireXn. Cmdty. Bull 2X	21.6	U.S. Glbl. Invs. Prc. Mnls.	76.2
ProFunds Precs. Mtls. Inv.	20.1	U.S. Global Invrs. Gold	74.7
DireXn. Lat. Am. Bull 2X Inv.	18.6	Oberweis China Opport.	71.7
DireXn. Emrg. Mkts. Bull 2X	17.1	Van Eck Invrs. Gold A.	67.6
LAGGARDS		**LAGGARDS**	
DireXn. Emrg. Mkts. Short	-15.2	Ameritor Investment	-88.9
DireXn. Sm. Cap Bear 2.5X	-15.1	DireXn. Emrg. Mkts. Short	-46.5
ProFunds UltSh. Emrg. Mkts.	-14.3	DireXn. Sm. Cap Bear 2.5X	-33.2
American Heritage	-12.5	ProFds. UltSh. Sm. Cap Inv.	-29.5

INTEREST RATES

KEY RATES

	NOV. 1	WEEK AGO	YEA
Money Market Funds	4.81%	4.84%	3.4
90-Day Treasury Bills	5.06	5.12	3.9
2-Year Treasury Notes	4.65	4.85	4.4
10-Year Treasury Notes	4.57	4.76	4.1
30-Year Treasury Bonds	4.69	4.88	4.
30-Year Fixed Mortgage †	6.10	6.28	6.

†BanxQuote

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	3.76%	4
Taxable Equivalent	5.37	5.
Insured Revenue Bonds	3.86	4.
Taxable Equivalent	5.51	6.

THE WEEK AHEAD

INSTALLMENT CREDIT *Tuesday, Nov. 7, 3 p.m. EST* » During September, consumers probably accrued another $5.5 billion of debt, after a gain of $5 billion in August. That's the median forecast of economists polled by Action Economics. After picking up in May and June, most likely boosted by soaring gasoline prices, gains in revolving credit have slowed.

INTERNATIONAL TRADE *Thursday, Nov. 9, 8:30 a.m. EST* » The September foreign trade deficit is expected to have narrowed a bit, to $65.7 billion. The August trade gap swelled to an unexpectedly large $69.9 billion. Lower energy prices should factor into a lower September deficit. Imports are forecast to have eased and exports most likely grew.

INITIAL UNEMPLOYMENT CLAIMS *Thursday, Nov. 9, 8:30 a.m. EST* » New filings for state unemployment claims likely held pretty stable, around 305,000, in the week ending on Nov. 4, from 308,000 for the week ended Oct. 21.

EXPORT-IMPORT PRICES *Thursday, Nov. 9, 8:30 a.m. EST* » Import prices probably tumbled 1.1% during October, after a 2.1% plunge in September. Falling oil prices are the main source of the decline. October export prices probably held steady, after a 0.5% drop in the prior month.

The *BusinessWeek* production i slipped to 283.8 for the week er Oct. 21, up 10% from a year Before calculation of the four-v moving average, the index impr to 283.7.

BusinessWeek onli

For the BW50, more investme data, and the components of the production index visit www.businessweek.com/extras

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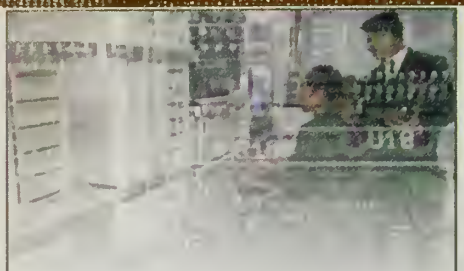

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Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A
Accenture (ACN) **80**
Accredited Home Lenders (LEND) **78**
Activision (ATVI) **84**
Acumen Assessments **44**
Adams Golf **112**
ADvice & ADvisors **42**
Aetna (AET) **18**
Agri-Energy **60**
Amazon (AMZN) **52**
America Online (TWX) **18**
AMR Research **80**
Anheuser-Busch (BUD) **126**
Archer Daniels Midland (ADM) **60**
Archeus Capital **32**
Aserta Sports **112**
Atari (ATAR) **132**
Atheros Communications (ATHR) **126**
Aurora Organic Dairy **18**
Austin Energy **74**
Aventine Renewable Energy **60**
Avis Budget Group (CAR) **32**

B
Bank of America (BAC) **76**
Bank of China **50**
Barnes & Noble (BKS) **52**
Bay Networks **112**
Bennett Group Financial **126**
Biosite **80**
Blue Origin **52**
BMO Capital Markets **76**
BMW **46**
BondDesk Group **124**
Borders (BGP) **52**
Bouchey & Clarke **118**
BP (BP) **32**
Burger King (BKC) **32**

C
Callaway Golf (ELY) **112**
Capital One (COF) **76**
Caremark Rx (CMX) **32**
Carter's (CRI) **126**
CastingWords **52**
Cbiz **118**
CBS (CBS) **26**
Cendant (CD) **32**
Center for Automotive Research **46**
Charles Schwab (SCHW) **124**
Chevron (CVX) **32**
Chrysler (DCX) **46**
Cisco Systems (CSCO) **37**
Citigroup (C) **34, 37, 76**
Clear Channel (CCU) **26, 32**
CMS **18**
Coastal Banking (CFCP) **12**
comScore Networks **18**
CoreLogic **10**
Countrywide Financial (CFC) **76, 78**
Credit Suisse **60**
Crosslink Capital **52**
CRSA **105**
CUC International **32**
CVS (CVS) **32**
Cyworld **72**

D, E
DaimlerChrysler (DCX) **46**
Delphi (DPHIQ) **32**
Downey Financial (DSL) **78**
DraftFCB **42**
East Japan Railway **10**
Efficient Frontier **52**
Enjoy China Holdings **10**
Enron **32, 134**
Entergy (ETR) **74**
ESPN (DIS) **84**
E*Trade Financial (ET) **124**
ExxonMobil (XOM) **32, 34**

F, G
Facebook **12**
FBR Small Cap Financial **76**
Fidelity Investments **124**
Fifth Third (FITB) **76**
Financial Stocks **12**
Firefox **24**
Five Star Dairy **60**
FMSbonds **124**
Foote Cone & Belding **42**
Ford (F) **52, 124**
GateHouse Media **26**
GE Capital (GE) **124**
General Electric (GE) **34**
General Motors (GM) **124**
GF Energy **74**
Golf Laboratories **112**
Google (GOOG) **18, 52, 72**
Great Eastern Bank **12**
Greylock Partners **80**
Grey Worldwide **42**

H, I
Harbor Bank **12**
Hewitt Associates **29**
HFS **32**
HighQuest Partners **60**
Home Depot (HD) **60**
IBM (IBM) **34**
ICBC **32, 50**
ING Financial Services **76**
Intel (INTC) **14**
Interactive Frontiers **112**
Interpublic Group (IPG) **42**

J
Javelin Group **84**
J.D. Edwards **80**
J.D. Power (MHP) **46**
JupiterResearch (JUPM) **72**

K
Keefe Bruyette & Woods **76, 78**
KFC (YUM) **32**
Kleiner Perkins Caufield & Byers **52**
Knight Ridder **26**
Kohl's (KSS) **84**

L
Leland's **108**
Linden Lab **52**
Littler Mendelson **44**
Longitudes Group **93**
Look-Look **72**
Lumera (LMRA) **126**

M
MacGregor Golf **112**
M&M Distributors **60**
Mastro Auctions **108**
McDonald's (MCD) **32**
Medtronic (MDT) **112**
Mercedes-Benz (DCX) **46**
Merrill Lynch (MER) **34**
Microsoft (MSFT) **24, 29, 52, 80**
Midway Games (MWY) **40**
MinWind **60**
MollyDooker **122**
Morgan Stanley (MS) **29, 32**
Motorola (MOT) **18**
MSN (MSFT) **18**
MySpace (NWS) **52, 72**

N
Native Instinct **72**
NBC Universal **26**
NetSuite **80**
News Corp. (NWS) **26, 52**
New York Times (NYT) **32**
Next Generation Equity Research **126**
Nike (NKE) **84**
NPD Group **84**
NRG Energy (NRG) **74**

O
Oak Associates **34**
Oasis **112**
Olstein & Associates **126**
Opera **24**
Oracle (ORCL) **80**
O'Reilly Media **52**

P
PayPal (EBAY) **52**
PeopleSoft (ORCL) **80**
Pequot **32**
Pfizer (PFE) **32**
Pinnacle National Bank (PNFP) **12**
Piper Jaffray (PJC) **52**
Portales Partners **78**
Powerset **52**
Prudential Equity **32**
Punk Ziegel **76**

Q, R
Quiksilver (ZQK) **84**
Qwest Communications (Q) **52**
RightNow Technologies **80**
Royal Dutch Shell (RDS
Ryan Beck **12, 76**

S
Safari (AAPL) **24**
Sakhalin Energy Investment **49**
salesforce.com **80**
SAP (SAP) **80**
Schaeffer's Investment Research **126**
Seiko Epson **18**
Sirius Satellite Radio (S **84**
Six Flags (SIX) **84**
SK Telecom **72**
SmugMug **52**
Spalding **112**
Standard & Poor's (MH **76**
Starbucks (SBUX) **12**
StarMine **52**
Stifel Nicolaus (SF) **52**
Strategas Research Partners **34**
Strategic Value Advisor
Sun Microsystems (SU **74**

T
Target (TGT) **52, 126**
TaylorMade Golf **112**
TD Banknorth (BNK)
Think-Equity Partners
Thomson Financial (TC **34**
Time Warner (TWX)
Titleist **112**
Tony Hawk **84**
Towers Perrin **29**
Toyota (TM) **46**
Tribune (TRB) **26, 32**
TXU Energy (TXU) **74**

U, V
UBS (UBS) **32, 34**
UnitedHealth (UNH)
United Technologies (U **34**
Vanguard **124**
VeraSun Energy **60**
Viacom (VIA) **26**

W
Wachovia (WB) **78**
Wal-Mart (WMT) **32, 4 52, 126**
Washington Mutual (W **76, 78**
Wendy's (WEN) **32**
Workday **80**
WorldCom **134**

Y
Yahoo! (YHOO) **18**
YouTube **52**
Yum! Brands (YUM) **3**

Z
Zions Bancorp (ZION

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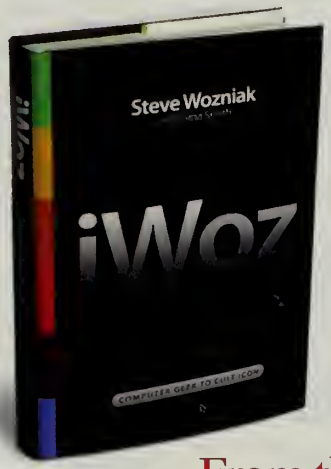
Apple's Other Steve Speaks

iWOZ Computer Geek to Cult Icon: How I invented the personal computer, co-founded Apple, and had fun doing it
By Steve Wozniak with Gina Smith; Norton; 313pp; $25.95

Steve Wozniak is a Silicon Valley archetype—the brilliant, idealistic engineer for whom fame and fortune were just a happy accident that occurred as he pursued his passion. In what many see as the most staggering burst of technical invention by a single person in high-tech history, the "Woz" saw past a swarm of proto-PCs in the mid-1970s to singlehandedly define the PC as we know it today. His Apple I and Apple II computers were the first successful personal computers because they came fully assembled, featured keyboards instead of punch-card readers, and had TV-style monitors for showing text and graphics, rather than just blinking lights.



In other words, Wozniak came up with what was likely the most influential product of the past fifty years—but you'd hardly know it if you met him. Steven Jobs, the younger sidekick who provided the entrepreneurial impetus to create Apple Computer Corp., has gone on to become a billionaire and one of the world's most powerful businesspeople. But Wozniak's role these days is as high tech's minstrel-in-chief. He's known for collecting odd gadgets such as a digital watch made with old-style vacuum tubes rather than chips and for organizing a polo league that uses Segway scooters instead of horses. When he gets serious, it's usually to bemoan how coin-obsessed the tech industry has become—more interested in blockbuster IPOs than in the sheer joy of great engineering.

If you want to know more, pick up *iWoz: Computer Geek to Cult Icon: How I invented the personal computer, co-founded Apple, and had fun doing it*. The 313-page memoir isn't for everyone. It's written in a conversational, almost sophomoric style and dwells more on youthful pranks than on inside stories from Apple's past. But *iWoz*' weaknesses are also its strength. This memoir truly reflects its author, both in its subject matter and its happy-go-lucky tone. No doubt, this ain't Dostoevsky. But Dostoevsky never wrote about the time he and Jobs narrowly avoided getting busted for having a "blue box" that could be used to make free phone calls to anywhere the world. Caught in the act at a pay phone by two cops, Wozniak ad-libbed, saying that his device was a music synthesizer. When asked what the orange button was, the teenage Jobs deadpanned that it was for "calibration." "These supposedly intelligent cops had totally bought our B.S.," Woz writes. "God, I wanted to laugh out loud."

There are other laugh-out-loud moments in the book, as well as some long passages where Wozniak tries—with only partial success—to dumb down some of his engineering triumphs for mere mortals. But there's real substance, too. Fo starters, his narrative shows how the process of innovation remains a matter of perspiration, patience, and coincidence. Thanks to sage advice from teachers and his engineer father, and confidence-building successes in the classroom and at science fairs, the painfully shy Wozniak figured out early that engineering held a joy he could not find among his schoolmates. Thus, despite his prowess as an athlete, he spent his free time reading technical journals and sketching improved designs for the computers of the day. Then, stints at Atari and Sylvania honed his ability to write software and get text and graphics to display on a TV screen. When he learned about the latest microprocessors at th first meeting of the now famous Homebrew Computer Club in March, 1975, he immediate saw how he could combine his collected knowhow to create what would soon become the Apple I. "It was as if my whole life had be leading up to this point," he writes.

At its best, *iWoz* is what its author says he hoped the book would be: an inspiration for nerdy kids who may feel "outside the norm." On the other hand, Apple fans will fin slim pickings. Wozniak even downplays the significance of his co-founding the company. Among the spar insights: the assertion that Mi Scott, the CEO who oversaw th landmark IPO in 1980, deserv more credit. And if there are a bad guys in the book, it's we ir the business press. He credits us with compounding Apple's woes in the mid-1990s with ou dour headlines and slams us f incorrectly reporting that he l Apple in 1985 in a huff.

From the guy who brought you desktop computing: Funny stories and inspiration

As for Jobs, Wozniak has nothing bad to say. He even forgives some past wrongs, such the time Jobs lied about how much they'd earned from Woz' 1973 invention of a computer game called Breakout for Atar Corp. Woz chalks it up to the fact he and Jobs were "differen people" and that the dispute isn't something worth worryin about. "I figure happiness is the most important thing in life just how much you laugh," he writes. That may not be the most sophisticated worldview ever, but it does make for an entertaining book—and a welcome, fresh perspective on an industry that seems so far removed from its original ideals.

–By Peter Burr

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BY ANNETTE L. NAZARETH

Keeping SarbOx is Crucial

As memories of catastrophic frauds such as WorldCom and Enron begin to fade, critics have gained traction with assertions that Congress overreacted when it enacted the Sarbanes-Oxley Act of 2002. I disagree. The Sarbanes-Oxley Act has been the most important and influential single piece of securities legislation since the landmark Securities Exchange Act of 1934.

It has promoted investor confidence, improved transparency, and increased corporate accountability. Although some fine-tuning around the edges undoubtedly is necessary, we have everything to gain by keeping SarbOx in place.

Just consider the breadth of improvements accomplished by the act. CEOs and CFOs are now required to certify the accuracy and completeness of their companies' financials. Insider trading reports must be filed electronically, giving investors quicker and easier access to this key data. Listing standards have enlarged the responsibilities of independent audit committees. For the first time, public accounting firms are inspected by an independent body, the Public Company Accounting Oversight Board. SarbOx also made it possible to distribute civil monetary penalties to compensate defrauded investors.

Many have ignored these benefits, preferring instead to focus on a single provision: Section 404. Under it, public companies must include an assessment of their internal controls over financial reporting in their annual reports. The reports also must include an auditor's opinion of the assessment.

Some complain that compliance is too costly. But many large companies have been complying with Section 404 for nearly three years. Their experience tells us two things: First, the cost burden during the first year was indeed significant, although it has decreased markedly. Second, there were palpable benefits from compliance, including improved efficiencies, better financial reporting, and enhanced detection and prevention of problems. A Lord & Benoit study even concluded that compliance with Section 404 was positively reflected in companies' stock prices.

Still, the initial costs and responsibilities of complying were admittedly troubling, and the Securities & Exchange Commission is working to address those issues. In December we will propose new guidance to management regarding assessment of internal controls. The PCAOB is also crafting significant amendments to Auditing Standard No. 2 that will be less prescriptive and more focused on increasing the cost-effectiveness of the audit process.

Some U.S. critics call it burdensome, but other nations are adopting similar laws

We must also craft guidance for the flexible, scalable application of Section 404 to smaller public companies, for which the costs of compliance could be disproportionate. However, a wholesale exemption of smaller businesses, as some have suggested, is not appropriate. There is no second tier for the integrity of a public company's internal controls.

Some believe the costs of complying with Section 404 have deterred companies from listing on U.S. exchanges. Contrary to that common misperception, companies listed in the U.S. still have a competitive advantage because they have access to the deepest capital pool in the world at the least expense. Individual investors represent a crucial component of that pool. Indeed, America has the highest percentage of individual investor participation in the world. These shareholders must have confidence in our markets, which SarbOx, including Section 404, has helped to restore.

Some have pointed to a drop in U.S. initial public offerings as proof that Section 404 has harmed American markets. In reality, U.S. IPOs have slipped due to a lower-interest-rate environment, the availability of private equity capital in the U.S., and the changing nature of businesses going public: Many are international companies or privatized state-owned entities that have chosen, for a variety of reasons, to tap foreign markets for their IPOs. The U.S. share of worldwide IPOs actually has increased since 2002.

It's noteworthy that other countries are adopting rules similar to SarbOx. Provisions roughly equivalent to Section 404 are in place in France and Japan, while both China and Canada are implementing similar safeguards. This suggests that SarbOx has not harmed our ability to compete but rather is viewed by other countries as providing valuable investor protections.

With the discrete refinements to Section 404 that are on the horizon, we can look forward to the promise of Sarbanes-Oxley being realized in a more cost-effective and efficient manner. America's investors deserve no less. ■

Annette L. Nazareth *has been a commissioner on the Securities & Exchange Commission since 2005. Her views are her own.*

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Send the Jerks Packing

How do you weed out the bad apples in an organization?
–David Michalek, Bartlett, Ill.

Start by putting down the pruning shears and picking up a buzz saw.

Look, nothing hurts a company more than when the bosses ignore, indulge, or otherwise tolerate a jerk—or two or three—in the house. Such latitude undermines organizational trust and morale, and without those, the competitive linchpins of collaboration and speed are just plain harder. Not to mention the fact that jerks take the fun out of work.

But before we talk about how to get rid of jerks—or bad apples, as you call them—let's be clear about who these people are. In business you can divide employees into four categories by looking at them along two dimensions: how well they perform—that is, how often they make the numbers—and how well they demonstrate company values. Now, "values" is a lofty and somewhat vague word, but all it really means is "behaviors." Values are how companies want their employees to act, which is why most lists include virtues like integrity and fairness. Those are necessary, but any list of values can, and should, also be linked to strategic goals. A company could, for instance, add values that say: We think and act globally, celebrate teamwork, show a strong bias for speed, or approach problems with urgency.

> Employees who make the numbers but undermine trust and morale must go—publicly

Back to the four types of employees. The first are people with good performance and good values. With these winners, management's job is easy—nurture, reward, and push onward and upward. The second are employees who have neither good results nor good behaviors. Again, the job is easy: Show them the door. A third kind of employee may deliver weak results for a year but still exhibit all the behaviors you want, so managers should give these well-intentioned people a second or third chance. Type 3 employees may have a particular performance issue, but they're not jerks.

Then there's a fourth kind of employee, the one who delivers the numbers but doesn't live the values. You know the type—who doesn't? They exist at every level in almost every organization. These high performers can be mean, secretive, or arrogant. Very often they kiss up and kick down. Some are stone-cold loners, while others are mood keeping those around them in a kind of terrorized thrall.

And yet, too often Type 4s remain unscathed. Sure, the bosses might rebuke them, but things usually don't chan after that. There's been no sting. Indeed, most of us have probably been guilty somewhere along the way of letting the burning desire for good results cover up the sins of an employee's poisonous behavior. We've squirmed and looked away.

You can't do that!

If you have a jerk problem, you have to stare it in the fa And that process can only start with a transformative eure Company leaders must come to believe that jerks hurt the organization more than they help. While their results are great, their collateral damage to the culture and overall competitiveness is far greater.

ONCE THE LEADERSHIP BUYS INTO that line of reasoning—a really feels it in their bones—getting rid of jerks is pretty straightforward. Managers have to make sure everyone in the company knows the values; they have to demonstrate them themselves, lavishly praise and reward them in othe and basically talk about the values *ad nauseam*. In fact, th values have to be so blindingly apparent to people in the organization that if someone doesn't live them, the interlo would be spotted immediately, like a player in a Yankees uniform showing up in the Red Sox dugout.

But the real clincher in ridding an organization of jerk is removing the ones you have and doing so with public fanfare. It's just wrong to can a person for a values violat and then soft-pedal the event with the line: "Joe left to spend more time with his family." Leaders need to say: "Joe had to go because he did not think globally," or if diversity is a value, "Joe was asked to leave because he w not gender and race blind in hiring." Every time you get of a jerk, don't miss the opportunity to make it a teachin moment. Pretty soon people will learn that jerk behavior a steep price indeed.

No organization will ever weed out all its jerks. Some w slip by because their performance is so terribly good or th bad behaviors are so frighteningly subtle.

But you can never stop trying to weed out bad apples. They're just rotten for business. ■

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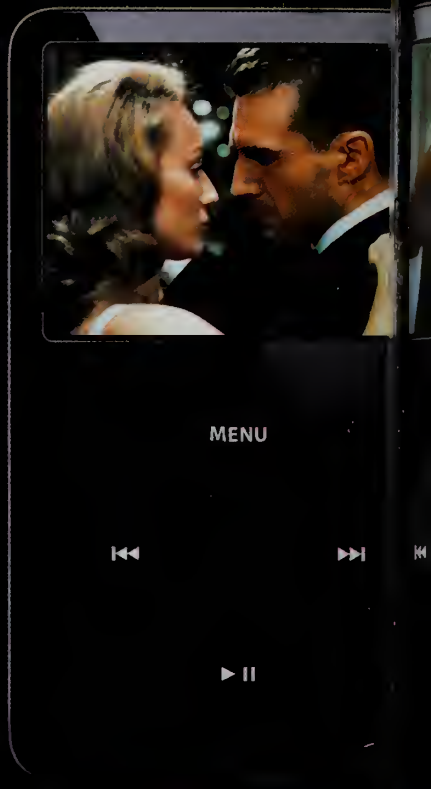
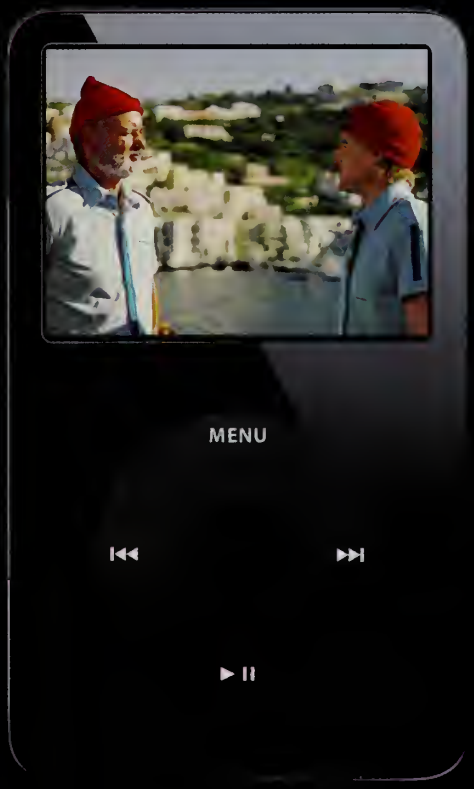
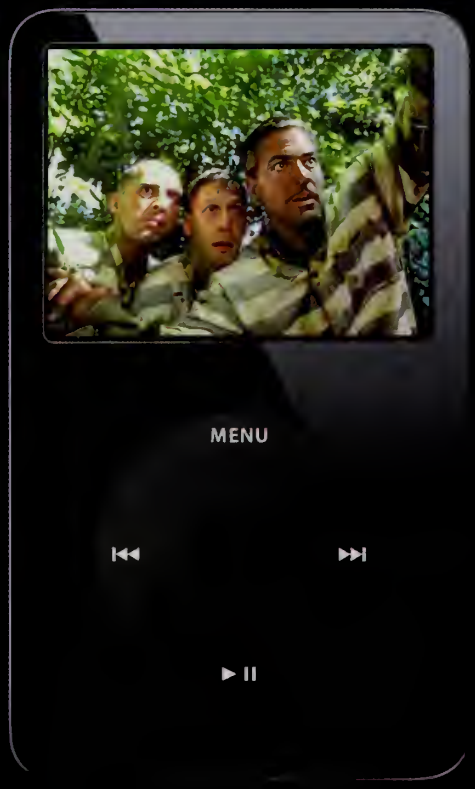
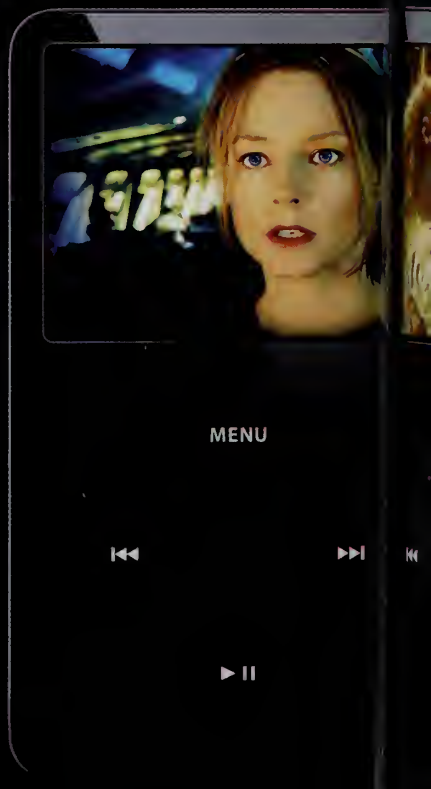
BY MICHAEL MANDEL (P.56)









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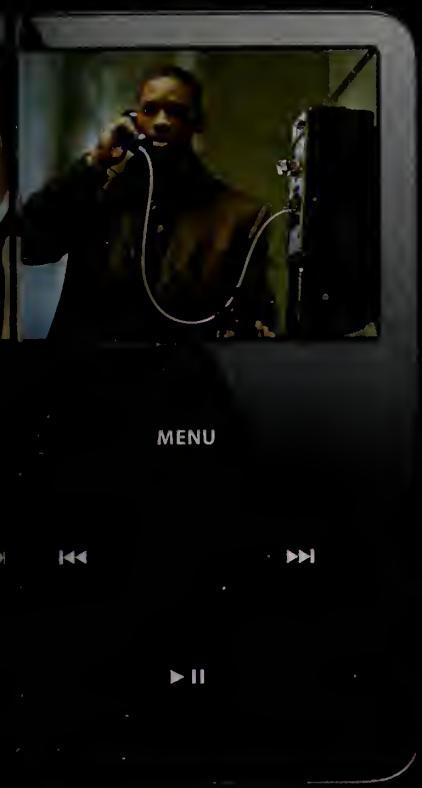

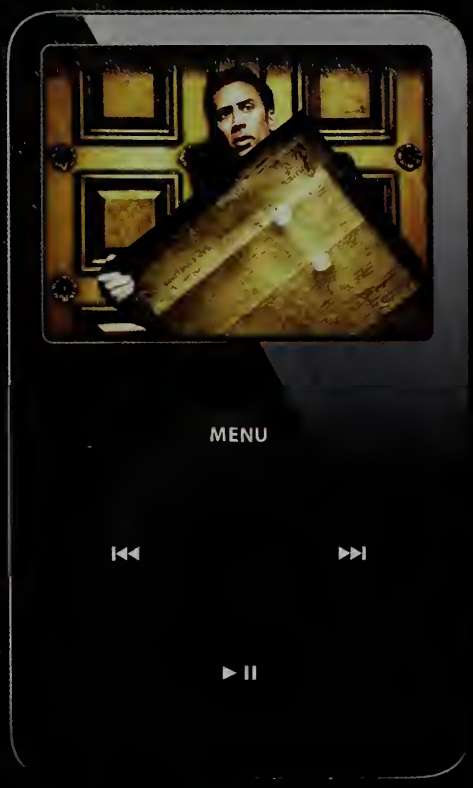

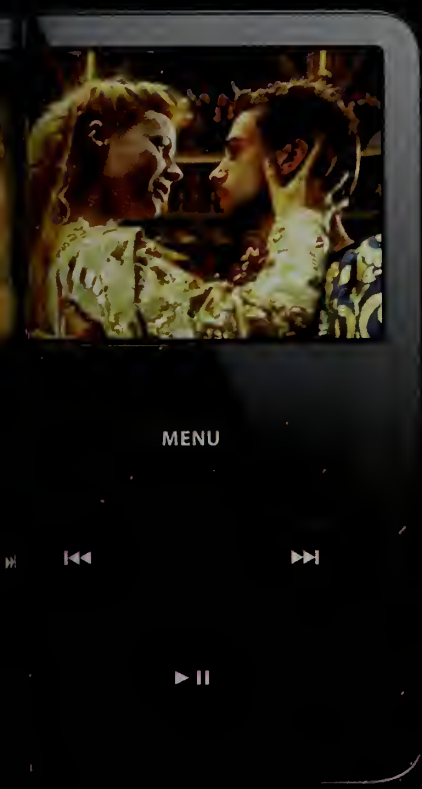

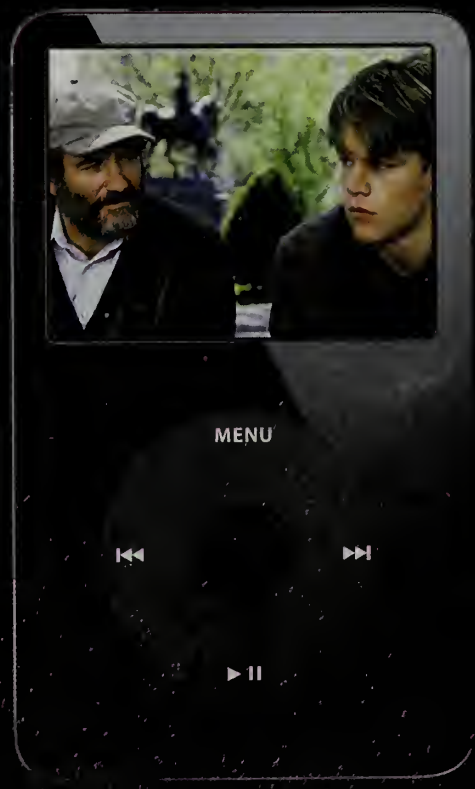

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2 News You Need to Know
ne election; FedEx jettisons Airbus; deluxe hotel bid; VW's new driver; ppy holidays on the Street; and more

News & Insights

7 Washington's New Math
y stats that can help the private sector aluate the election results

0 Habitat for Hustlers
wners of the affordable homes e falling victim to high-interest financing deals

2 All That Money Has to Go Somewhere
eap interest rates and leveraged yout firms awash in cash are fueling explosion of mergers

4 The Taking of MGM One, Two, Three
hat Sony's private equity partners ally want to do, it seems, is run the ow

7 Big Blue Finds a Second Life
M is embracing the virtual world— d other companies are close behind

Global Business

3 India: Rolling in Rupees
e nation's surging class of llionaires is buying luxury cars, travagant homes, and designer duds

) New Life in Old Plants
S. companies are getting great returns t of refurbished factories in Eastern rope that they bought on the cheap

2 From Soviet Clunker to Speed Demon
w investors, foreign technology, and a van have carmaker GAZ zooming

5 Clash of the Economic Titans
dia and China represent radically ferent development models, and their mpetition is just starting

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Cover Story

56 Can Anyone Steer This Economy? Global forces have taken control of the economy, and the flow of goods and money across national borders is giving policymakers fits. And the federal government, regardless of whether the Democrats or the Republicans are in power, will have less influence than ever

NEWS & INSIGHTS

34 House of Democrats
What does the electoral rout of Nov. 7 mean for business? Certainly it will have to forge new alliances, especially with Dems heading powerful committees. Yet the real new power brokers may be the centrists. And bipartisanship will still have a chance to flower

CONTENTS

24 | ZUNE VS. iPOD

100 | 007 GETAWAY

96 | CELL THERAPEUTICS

Finance

64 Rewriting the GAAP
FASB thinks it may be time to bring more investors on board

66 Banco Wal-Mart
Mexico is likely to let it become a bank there—and shake up a cozy industry

People

70 Getting Marsh out of the Swamp
Mike Cherkasky's job now is to unify the firm's fiefdoms

Entrepreneurs

74 The Sweet Revenge of an Energy Guy
Fired as a gas salesman, Jim Headlee now finds energy discounts for clients

The Corporation

76 L.L. Bean: Prettier in Pink Flannel?
It's emphasizing apparel at its brick-and-mortar outposts to pep up sales

78 Temp Labor: The Roof Springs a Leak
The housing fall-off threatens earnings at the largest provider of temporary muscle

82 Putting Managers to the Test
How Korn/Ferry matches talent to vacancy

Managing

93 In the Trenches at VF Boot Camp
Our reporter finds execution is everything at the training seminar

Science & Technology

96 Is Cell Therapeutics in Remission?
The battered biotech's controversial CEO wins over Novartis, but not investors

99 Developments to Watch
Fires and global warming; biodegradable stents; cleaner transplant tissues

Executive Life

100 Bond. James Bond. For a Day
Adventure travel in a Cold War town

104 Underground Treasure
Where to indulge in white truffles

108 Mike Marrone: My Tunes
If you don't know Phil Roy, it's high time

110 Parker on Wine
Penfolds Grange is a stellar shiraz. But the Aussie winery makes other stars, too

Personal Finance

112 Quirkiest Vehicle on the Street
Structured notes can protect principal and help gains, but liquidity can be poor

Columnists

18 Kerry Sulkowicz: Analyze This
The prestige and peril of CEO pay

24 Steve Wildstrom: Tech & You
Microsoft's new Zune music player

28 Jon Fine: Media Centric
Is a Fox business channel really a go?

29 Jim Cooper: The Business Outlook
Productivity growth takes a dive, and that puts the Fed on the spot

114 Gene Marcial: Inside Wall Street

122 Maria Bartiromo: Face Time
Charlie Cook explains the election

124 Jack and Suzy Welch: The Welch W
Starting a new venture inside the old one

Ideas

120 Books
Tedlow: *Andy Grove: The Life and Tim of an American*
Jack & Suzy Welch: *Winning: The Answe*

Features

13 UpFront
20 Readers Report
22 Corrections & Clarifications
117 Figures of the Week
118 Index to Companies

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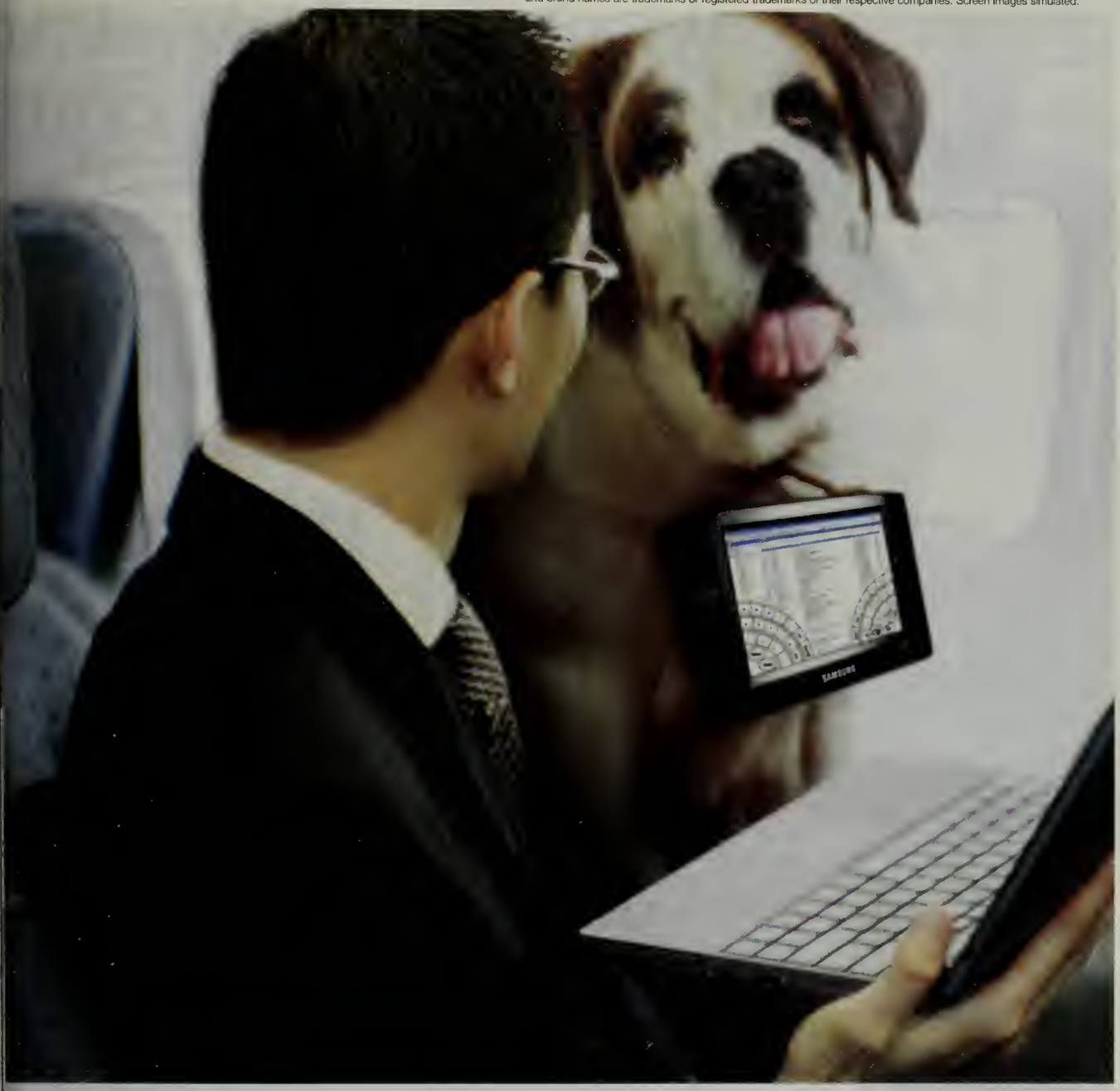

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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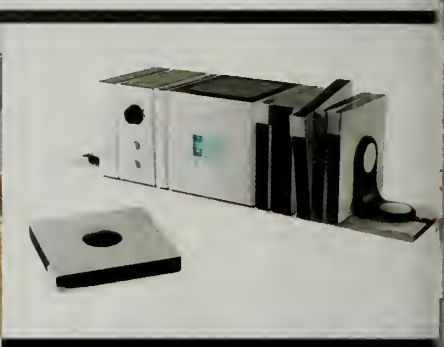

Next-Generation Computing

They're reaching flood stage, those **rising rivers of data** coursing through the Internet and corporate networks. Computer users are sending, receiving, and storing ever increasing amounts of information, and it's beginning to put a strain on the facilities that aim to manage the flow. BusinessWeek.com's **Special Report** on Next-Generation Computing explains how a host of companies, from stalwarts like Cisco Systems and Sun Microsystems to newcomers such as VMWare and XenSource, are crafting ways to help companies cope. One solution will be **PCs that meet the growing demand** for information and entertainment anywhere, all the time. To see how they'll get there take a look at our slide show. Anyone who has ever lost sleep over computer security will want to read up on how a startup called MagiQ Technologies harnesses quantum physics to **keep your data from prying eyes.** And, in a Q&A, IBM vice-president Dave Turek explains how supercomputers, the Formula One speedsters of tech, will influence mainstream computing. For all this and more go to **www.businessweek.com/go/06nextgen.**

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JP Front

"Actually, I thought we were going to do fine.... Shows what I know."

–President George W. Bush, on the Democrats' strong showing in the Nov. 7 midterm elections..

DITED BY DEBORAH STEAD

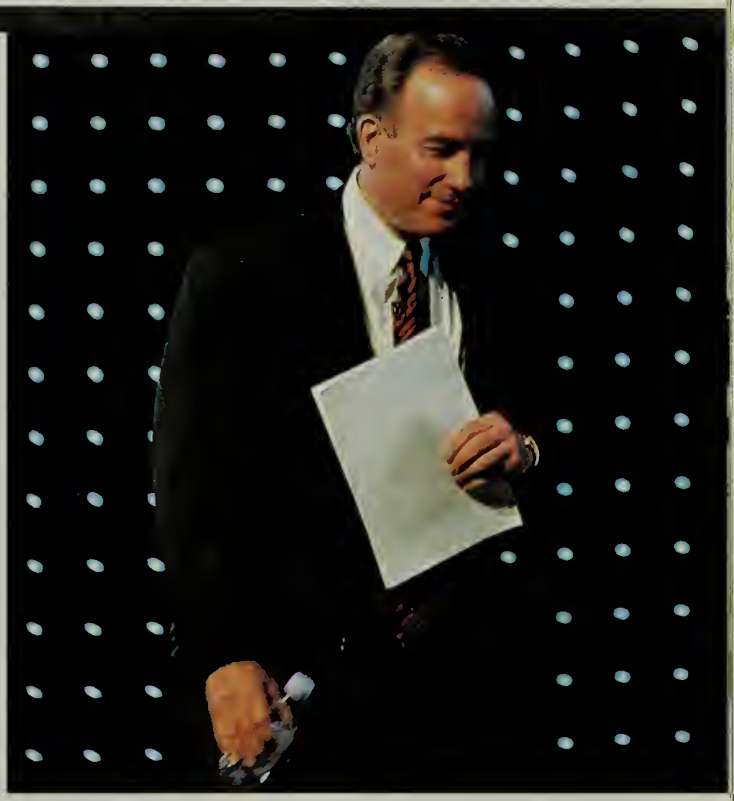
CEO PAY

Verizon: Ivan's Focus on Fiber

S MORE SUBSCRIBERS itch their traditional phone nes and get courted by able companies, Verizon ommunications is spending lmost $25 billion to extend ber-optic service to millions f homes. Shareholders have een feeling the cost of the roject, which enables Verizon offer consumers a TV, nternet, and phone package. ollout costs this year diluted arnings by 11%, about 30¢ er share, according to a ecent company briefing.

But does Verizon's CEO ave the same skin in the ame? The board has decided make Ivan Seidenberg's ng-term incentive pay ss tied to Verizon's stock erformance and more ed to the fiber rollout's success. The company won't elaborate on what constitutes success, stressing instead that the arrangement allows Seidenberg to focus on the long term and not on short-term hits to Verizon's stock price. "There is some pain in the near term," concedes spokesman Eric Rabe, referring to the project's cost. "But the alternative of not investing in the rollout is not in shareholders' interests."

Critics aren't so sure about that. Telecom analyst Zhiping Zhao of CreditSights characterizes the fiber-op rollout as an exercise in losing money just to grab subscribers. "You're burning cash," she says, noting that Verizon is offering service comparable with standard cable TV for $39.95 a month, about $10 less than what cable and satellite rivals charge. Her take on management's prediction that the network will show operating profits by 2009: "It's fiction."



SEIDENBERG At a Vegas telecom confab

To be sure, Seidenberg's short-term bonus is still tied to quarterly financial targets. Still, his fiber-op incentive "is not in the best interest of shareholders," Zhao argues. "It's a decision decoupled from economics—like, 'We're going to reward the CEO regardless.'"

–Roben Farzad

VERBATIM

THE ART OF UNDERSTATEMENT From a recent deposition of former Enron CFO Andrew Fastow, taken as part of a civil case against banks filed by Enron shareholders who allege that the banks participated in fraudulent deals with Enron to help hide the company's debt. (*In re Enron Corporation Securities Litigation;* U.S. District Court, Southern District of Texas)

Q: Is your attitude towards shareholders different now than it was while you were CFO?

A: I would say yes.

Q: How has it changed?

A: Well, I think by doing what I'm doing now, I'm trying to help shareholders, and many of the things I did while I was at Enron ultimately did not help shareholders.

UPFront

SOCIAL STUDIES

NOW THERE'S PROOF. TV IS BAD

In his 2000 book, *Bowling Alone*, sociologist Robert Putnam argues that excessive TV watching frays social ties. Benjamin Olken, a Harvard economics researcher, says he may have proved Putnam's case against TV, using data from the Indonesian island of Java.

Because TV reception varies within Java's rural eastern and central provinces, people watch more TV in some villages than in others. The result: less civic-mindedness in the good-reception areas. Olken found that the availability of one extra channel was linked to a 7% decline in the number of a village's social groups and an 11% decline in the number of school, neighborhood, or savings circle meetings the average adult attended.

The shriveling social capital didn't seem to worsen village governance, though. A road project was managed just as well in the villages with good TV reception as in the bad-reception communities, Olken says, perhaps because a drop in social trust "encourages citizens to monitor government more."

–*Peter Coy*

PHONE WARS

SAY HELLO TO THE FOLKS BACK HOME

IMMIGRATION may be a political headache in Spain, but it's a boon for British cell-phone operator Vodafone, which is signing up immigrants by the, uh, boatload. Vodafone's Spanish subsidiary says it has snared a half-million new subscribers in the past month after launching its *Mi País* (My Country) ad campaign, offering the equivalent of 23¢-a-minute calls to 50 countries.

Spain has one of Europe's fastest-growing immigrant populations, with more than 600,000 foreigners arriving annually, mainly from Africa, Latin America, and Eastern Europe. About a year ago, the country granted amnesty to nearly 700,000 illegals.

RINGING UP SALES Marketing t immigrants in Spain is paying off for Vodafor

Most of the immigrants are poor. But Vodafone says that 90% have cell phones and that they tend to run up higher bills than locals: They make more international calls and often don't have home phones. Because many immigrants lack bank accounts and credit cards, Vodafone also sells prepaid *Mi País* calling cards in tobacco shops and large newspaper stands. And it has set up customer service hotlines in 11 languages, fro Arabic to Romanian. It even offers reduced fees on foreig countries' national holidays Vodafone claims that 40% o Spain's immigrants subscril to its service. The campaign is part of a push to raise its 31% share of Spain's mobile market to challenge local operator Telefónica, which has 46%. –*Carol Matla and Joan Tarzi*

HANGING AROUND

THE GHOST IN THE CATALOG

RICHARD THALHEIMER, founder of The Sharper Image, has appeared in issue after issue of the retailer's catalogs. The Holiday 2006 catalog is no exception—despite the fact that Thalheimer stepped down as chairman and CEO more than a month ago. The issue, which arrived in homes in mid-October, features two letters from Thalheimer in which he talks up various products with his characteristic enthusiasm. Beneath his smiling headshot, he is identified as company founder.

Thalheimer's Sept. 26 ouster from the San Francisco-based retailer—he remains a company director—followed years of stagnant sales and a board makeover led by the investment firm Knightspoint Partners. Might the new management, led by Chairman and interim CEO Jerry Levin, be using Thalheimer as a familiar public face while the company gets its bearings? The company says no. Thalheimer "will not be featured in future issues of the catalog" and will be phased off the Web site, says spokesperson Michael Gross adding that the holiday catalog "was already being printed" when Thalheimer stepped down. Scheduling issues may also explain why the catalog cover features th company's signature Ionic Breeze air purifier despite analyst critiques that Ionic Breeze products hav dragged down sale Levin and his team are developing "nev marketing and prod strategies," says Gro –*Elizabeth Woy*

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UPFront

RUMBLINGS

AN EXECUTIVE UPGRADE AT DELL?

MICHAEL DELL is on a search for new talent—trying to upgrade a management team critics say has become complacent. Dell, who owns 10% of the computer maker and is its chairman, is looking for a new exec to run his fast-growing services business. Some insiders wonder if his personal involvement in the search means he's preparing for the departure of embattled CEO Kevin Rollins. Dell calls such talk "nonsense." But the search comes as the "direct from Dell" model is struggling. Dell has missed financial targets in four of the past five quarters and is expected to announce a third-quarter income drop on flat sales on Nov. 16.

MICHAEL DELL
Looking for talent

Sources say the company wants to hasten its move beyond low-end PC-repair and into the lucrative business of helping manage companies' computer operations. So far, they say, Dell has contacted Robert Zapfel and Elizabeth Smith, of IBM's services business, and Steve Smith, formerly of Hewlett-Packard. All declined to comment.

Dell has also been looking for a new marketing chief, and, say some industry sources, it would do well to hunt for a new head of the consumer business as well. Michael Dell wouldn't comment on future hiring, adding that all top brass report to him and to Rollins, "and that's not going to change." *–Louise Lee and Peter Burrows*

CREATIVE DESTRUCTION

A HANDFUL OF enterprising community banks are bypassing tote bag and key chain giveaways for some productively destructive marketing: free document-shredding services. As customers and noncustomers alike line up to feed their old financial records into a shredding truck, they get information on the bank's new financial products and services. Mercantile Potomac Bank in Gaithersburg, Md., which began holding quarterly Community Shred days in mid-2005, routinely gets up to 1,500 participants at its sessions, according to industry publication *American Banker*, followed by an immediate increase in Web site hits and call-center inquiries. *–Lindsey Gerdes*

DOCUMENT WATCH

BESIEGED BY probes into its practices, Halliburton subsidiary KBR has included 26 pages of "risk factors" in the amended IPO registration it filed with the SEC on Oct. 31, a document that returns 179 hits for the term "investigation." And that's for starters. Not listed as a risk, of course, is a Democratic Congress. Nor is a broad audit begun in September by the Defense Dept.'s Inspector General to examine allegations by Senator Byron Dorgan (D-N.D.) and others that nonpotable water KBR provided to troops in Iraq was contaminated. Halliburton disputes Dorgan's findings that the water, used for bathing, made soldiers ill. *–Dawn Kopecki*

Hitachi true stories

SMALLTOWN OREGON LOGS ON

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The rugged Oregon coast is the last place you'd expect to find America's first 2.5 gigabit-connected town. But here's where it all started, thanks to fiber-to-the-home technology from Hitachi.

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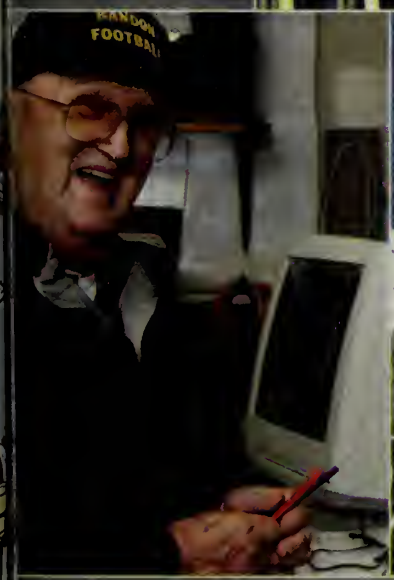

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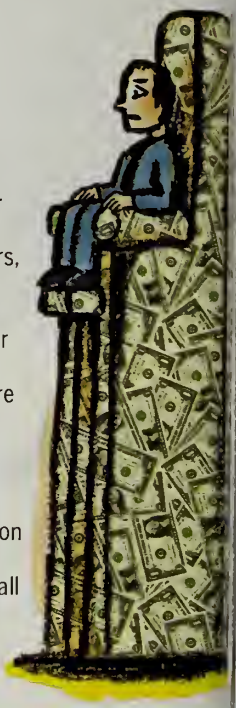
ANALYZE THIS BY KERRY SULKOWICZ, M.D.

CEO Pay: The Prestige, the Peril



At lunch in Manhattan not long ago, a well-paid chief executive asked me what I thought about the psychology of CEO pay. Why is everyone fixated on the topic? he asked. Does such hefty compensation, including his own, just come down to greed?

"I THINK there's more to it than that," I answered. In part, greed may account for these huge salaries and perks. But for some CEOs, high pay is also a status symbol, the currency of competition with other CEOs. Other chiefs expect big packages because they've internalized our culture's view of CEOs as celebrities or potential heroes. If Alex Rodriguez can make about $20 million a year with the Yankees (and not come through in the clutch), the thinking goes, don't CEOs deserve an extra zero or two?

I also know CEOs who view their pay not just as a reward for years of climbing the corporate hierarchy but also as an insurance policy, something to sustain them after their headliner days are over. (In this way, they're not unlike the sluggers who worry about life after baseball.) Fat packages represent their way of mitigating anxiety at a time when CEOs are assuming more risk and being fired more readily than ever before. And since money equals love for many people, why shouldn't that operate for CEOs, whose jobs often consign them to isolation and loneliness?

Since we're talking about the psychology of CEO pay, we should also look at compensation's impact on a chief's personality and on his board relationships. Superstar pay can reinforce latent grandiose tendencies in those so predisposed. A 2005 article by Washington University Law School professor Troy Paredes hypothesizes that high pay can contribute to a CEO's overconfidence—in the face of which, board members are likely to be more deferential and less able to spot bad business decisions.

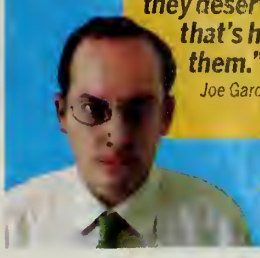
I'VE ALSO encountered boards who are quite nervous about whether their CEO—especially one they've selected—will succeed. Using circular logic, they grant a big pay package to bolster their own confidence in the chief. A few CEOs actually feel uncomfortable with the high pay their boards urge them to accept. But given their directors' fear that lower pay might send the wrong message to the company or investors, they feel they can't afford the luxury of such modesty.

Now to why we care. CEO pay has never been higher, or as disproportionate to the pay of other workers, as it is now. So questions about what this means for others—investors and employees—are understandable. Still, greed's close cousin, envy, can disguise itself as righteous indignation in some quarters, where every downfall of a highflying CEO is secretly greeted with glee. All parties could stand a dose of self-awareness: Salivating bystanders might want to keep their envy a *Schadenfreude* in check. CEOs should refle on the impact of their pay on their behavior And directors should take a hard look at boardroom dynamics that may encourage pay decisions they later come to regret.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executi on psychological aspects of business. Send hi questions at analyzethis@businessweek.com.

QUESTION OF THE WEEK

AD INFINITUM Product placement, viral marketing, bloggers paid to hype brands, ads even in elevators. Is advertising today creative—or creepy? How far should Mad Ave go?

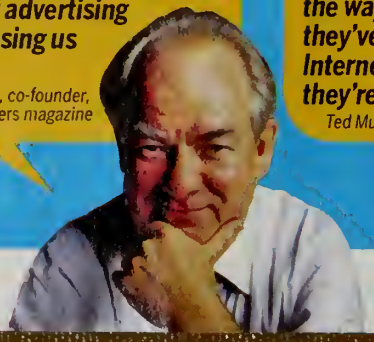


"That line of demarcation was obliterated years ago, when they started naming ballparks after brands. And if people don't read all blogs with a discerning eye, they deserve any deception that's heaped upon them."

Joe Garden, features and business affairs editor, The Onion

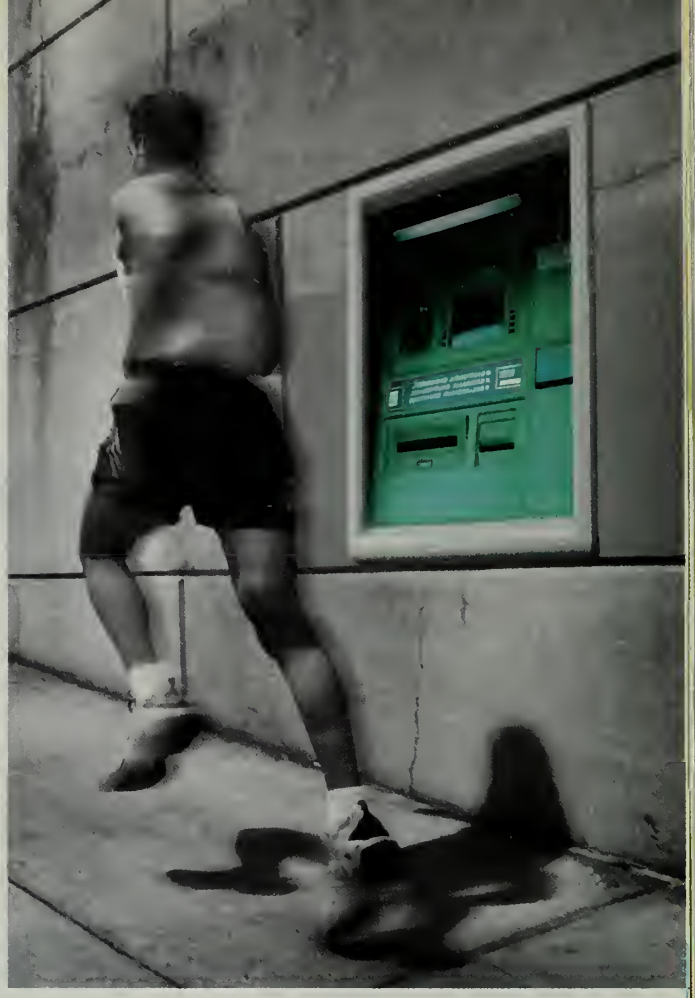
"From the moment you get up in the morning, you're basically assaulted. About 3,000 marketing messages a day seep into the average North American brain. That level of advertising is stressing us out."

Kalle Lasn, co-founder, Ad Busters magazine



"The amount of product placement is amazing in any reality show. The younger generation recognizes that if they want free content—and that's the way they are because they've been raised on the Internet—it's a trade off they're willing to accept."

Ted Murphy, CEO, PayPerPost.com



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> Private equity firms... are every bit as dangerous and deceitful as unregulated hedge funds....
>
> *–Alan MacDonald*
> *Sanford, Maine*

'GANGSTERS AND CON ARTISTS' AT THE GATE

IT'S NO SURPRISE that since the faux reform of corporate corruption from the Enron era, *BusinessWeek* has been looking more like an issue of *True Crime Stories*.

"Gluttons at the gate" (Cover Story, Oct. 30) details the schemes and vocabulary of private equity firms that are every bit as dangerous and deceitful as unregulated hedge funds, the difference being merely in terminology—"loans to own" rather than "side letters" and "side pockets." This is the language of gangsters and con artists rather than productive capitalists.

–Alan MacDonald
Sanford, Maine

CAPITAL ONE: OUR CUSTOMERS ARE DOING FINE, THANKS

"CAP ONE'S CREDIT trap" (News & Insights, Nov. 6) was missing key facts about Capital One and could have left readers with a false impression.

Capital One rigorously manages credit, and our charge-off rate is consistently among the lowest in the industry. It is not in anyone's interest for customers to have access to credit they can't handle.

The vast majority of our customers have one card with us, and only a sn fraction have more than two. Howe there is nothing particularly nota about the fact that customers have m than one credit card, whether with issuer or different issuers. CardWeb ports that Americans carry 6.3 b credit cards per household on averag

Also absent from your article the fact that our customers can cho to consolidate their Capital One ca if their accounts with us are in g standing, except in very limited circu stances relating to specialized cards small business and certain national re partners.

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We are committed to delivering g products to our tens of millions of tomers and to helping them man credit responsibly. If any of our cust ers are struggling to meet their paym obligations, we will work with then attempt to find a solution.

–Richard W
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ReadersReport

ANALOG DEVICES AND SO-CALLED ACCOUNTING TRICKS

ACCELERATED VESTING in no way "pumped up profits for the company in 2005" because Analog Devices Inc. did not expense options in fiscal 2005 ("Master of the options universe," News & Insights, Oct. 23). Additionally, ADI's officers and directors were specifically excluded from the vesting change.

The Financial Accounting Standards Board requirement that all companies expense stock options took effect in our fiscal 2006. FASB and Securities & Exchange Commission rules prescribe how to estimate stock option expense and expected volatility, which is one of the assumptions that determines the stock option expense. It is the stock market that drives the stock price volatility of all companies. ADI's stock price and those of our direct peers were much less volatile in 2005 than during earlier years, resulting in lower volatility assumptions.

Alleging that this change amounted to "accounting tricks" ignores the rules and the fact that it is the stock market itself that drives the measurable price volatility of all companies.

Finally, the article neglected to mention that, unlike many companies revie ing their stock option practices, ADI v not be required to restate any financ results due to issues with our options.

–Ray St
Chairm
Analog Devices I
Norwood, M

Editor's Note: The article incorrectly sta that accelerated vesting increased Ana Devices' profits in 2005. The correct ti period was fiscal 2006.

CORRECTIONS & CLARIFICATIONS

"The organic myth" (Cover Story, Oct. 16) featured a photo of a contract farm that has raised conventional and organic cows for customers such as Aurora Organic Dairy. Aurora says the animals featured in the photo are not part of its herd.

In Jon Fine's column "NBC's script needs a rewrite" (Media Centric, Nov. 6), the figure given for NBC Universal's total 2005 revenues was incorrect because of a production error. The correct figure is $14.7 billion.

A table on the holiday sales expectations of chief marketing officers at leading retailers (Up Front, Nov. 13) misidentified the survey's source. It is *BDO Seidman Retail Compass Survey*.

"Jeff Bezos' risky bet" (Cover Story, Nov. 13) should have made clear that startup Powerset Inc. will launch its Web-search service next year. The company will announce its plans for the service in mid-November.

WEBHELP'S ROOTS LIE IN CANADA, NOT FRANCE

I READ "GO EAST, young man" (Glo Business, Oct. 30) with great disappoi ment. Your article failed to mention t the company Webhelp was the brainch of Kerry Adler, Laura Hantho, Hu Cumming, and Dan Walter. As veter of the call center industry in North Am ica, we launched Webhelp Worldwide late 1999 and successfully raised m than $100 million.

The concept was to take our years business-process outsourcing experie to more cost-effective markets. India v first, followed by Sri Lanka, Mex

l then Canada. With several thousand ployees worldwide and two failed ini- public offering attempts (during the -com crash), the company eventu- merged with two other companies to m TWS Holdings.

Webhelp France, which you refer to as bhelp, was simply a licensee of ours t bought the rights to use the Webhelp ne, business plan, and technology. We ped them build their business as a lica of our Canadian business model.

–Kerry E. Adler
Founder, former president, and CEO
Webhelp Worldwide
Toronto

O LITTLE TRANSPARENCY IN E BOND MARKET? BLAME THE SEC

HAT COULD STOKE the bond market" nance, Oct. 30) did not mention that, many years, the barrier to broader eq- -type bond price disclosure—particu- y for individual investors—has been, l remains, the SEC. Yet the SEC pats lf on the back for helping promote at is an inferior price-reporting system t hides the disclosure of prices and npensation paid on bond transactions. e the SEC has utterly failed in its self-described role as the investor's advocate.

–Fred Siesel
Former SEC staffer
New York

JEFF SKILLING MIGHT HAVE BEEN BETTER OFF WITH NO DEFENSE

"ONE OF THEM is still laughing" (Up Front, Oct. 30) reports that Jeff Skilling paid $70 million for his defense, yet he ended up with 24 years. I wonder what the punishment might have been had he just pleaded guilty and paid nothing?

–T. Glenn Blakney
Vice-President
Brookwood Securities Partners
Beverly, Mass.

YES, AMERICA USES MORE RESOURCES—TO PRODUCE MORE

"AMERICA'S supersized footprint" (Outside Shot, Oct. 30) bemoans the fact that the U.S., with 5% of global population, uses 25% of global resources. Victoria Markham should know, however, that a country's use of resources is closely related to its gross domestic product and therefore to its standard of living. The U.S. produces around 25% of the world's products and services. So on that basis, its use of resources is not out of line. In a number of countries, including Australia and Canada, the resource-to-GDP ratio is high. Is the author really arguing that the U.S. should use only 5% of the world's resources? Would she prefer that the U.S. have the standard of living of Bangladesh, Zimbabwe, or Haiti?

–Danek Bienkowski
Almont, Colo.

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Tech&You

BY STEPHEN H. WILDSTROM

Microsoft Plays a New Zune

Microsoft has never been shy about adapting a good idea when it sees one, so naturally its new Zune music player and download service take a page from Apple's iPod/iTunes business. Zune's large display and wireless capability may well appeal to some users. But they won't be enough to overcome the huge head start Apple enjoys in the market.

Zune represents an abrupt reversal of Microsoft's earlier music strategy, which was supplying software to music vendors and independent hardware makers. These iPod wannabes have improved of late, but they still haven't caught up to Apple, and the various music offerings fall far short of the seamless experience on the iTunes Store. With Zune, Microsoft adopts Apple's model of end-to-end control of hardware, software, and content retailing.

Microsoft hopes Zune's ability to share music will be the killer distinction, as implied in its marketing slogan "Welcome to the Social." The players use Wi-Fi wireless to detect any other Zunes within about a 30-foot radius and send them songs. A shared song can be played just three times in a three-day period unless the owner cables the Zune to a PC and buys the tune from the Zune store. Unlike the player from startup MusicGremlin, which also offers Wi-Fi sharing, the only wireless downloads the Zune can receive are songs sent from other Zunes.

THE $249 ZUNE PLAYER IS AN ATTRACTIVE design, available in black, brown, or white. It has 30 gigabytes of storage and is about ¼-in. longer and thicker than the similarly priced 30 GB iPod. But it makes good use of the extra bulk with its substantially bigger 3-in. display. It also has an FM radio. And while the controls lack the elegant minimalism of iPod's scroll wheel they are well designed and efficient. I had some difficulty installing the software—which requires Windows XP Service Pack 2—and getting the player to sync. But I was testing a preproduction version of the program; the problems should be fixed by the Nov. 14 launch.

The Zune player can handle the standard, unprotected audio and video files common to portable players. But when it comes to copy-protected content, it will only take files purchased from Zune Marketplace. Songs and videos protected by earlier versions of Microsoft's own digital rights management software, including PlaysForSure, will not work.

On the screen, the black, gray, and orange hues of the Zune library software have a more modern look than the rather plain-vanilla iTunes, even though the basic layout is similar. It is a vast improvement over the familiar Windows Media Player.

The Marketplace music store is more problematic. For the sake of consistency with Xbox Live, prices are given in Microsoft points, equal to about 1.25¢, a system that strikes me as silly. Songs are priced at 79 points, which works out to the 99¢ they cost anywhere else. Zune users have the option of a $15 monthly subscription, which allows unlimited downloads, but the music disappears if the subscription lapses.

> Wireless sharing sets it apart from iPod. That might not be enough

The ease of browsing at the store is hindered by the fact that all music is sorted into just eight popular genres and a catchall "more" category, instead of the extensive system of genres and subgenres used by iTunes.

The big problem with the Marketplace is what isn't there. Zune is a much better video player than the iPod, but there are no movies or TV shows for sale, and won't be until Microsoft works out agreements with the studios and networks. Zune can play podcasts, but you can't subscribe to or download them through the Marketplace.

Maybe I am underestimating the desire of people, especially those of the MySpace generation, to share music by a more high-tech method than passing earbuds back and forth. If I'm not, Microsoft's only hope may be to top iTunes' menu of video offerings before Apple comes out with an enhanced video iPod, which could happen as soon as January. It looks like it's going to be a bumpy ride. ■

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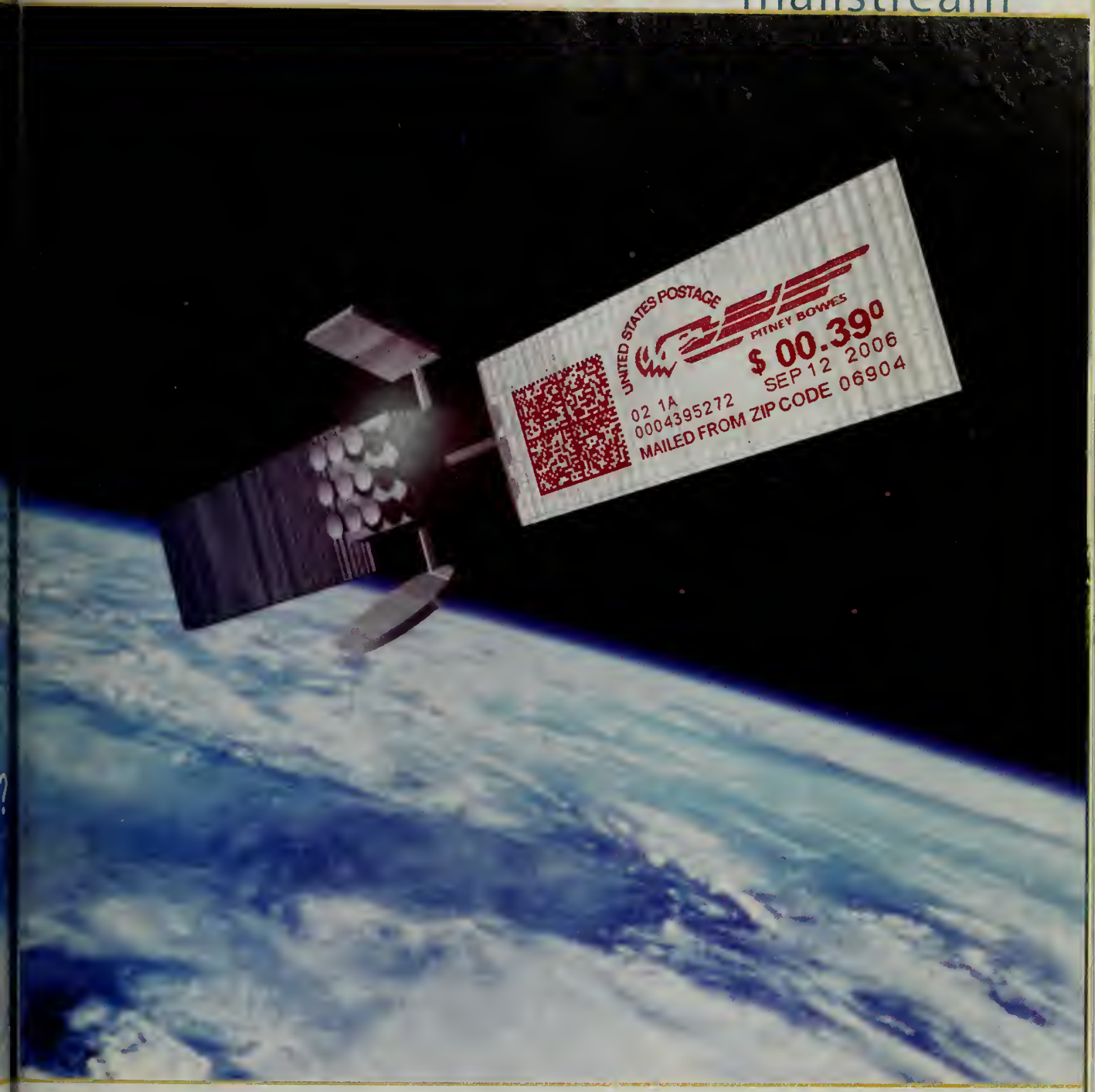

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MediaCentric
BY JON FINE

Is Fox's Business Channel a Go?

Chatting with Rupert Murdoch at an investor conference some weeks back, I asked the News Corp. chairman where things stood with his long-awaited Fox business channel. "We're hiring people," he said—note plural—with an eye toward an '07 launch. This conversation came just a few days after the announcement that former NBC on-air star Alexis Glick would serve as director of business news at the Fox News Channel and play a role on a business channel should one launch. Now comes word that Comcast, the nation's largest cable outfit, will carry the channel on its digital service.

Murdoch & Co. first floated the notion of a 24/7 business channel two-plus years ago, and we're still waiting. This is unusual in the House of Fox. Murdoch generally trusts his gut and goes for broke. Case in point: He bucked conventional wisdom and launched an alternative news channel. (It worked.) He has waxed confident and expansive about the still-not-official, still-unnamed business channel. Interestingly, Roger Ailes, chairman and CEO of Fox News Network and the savvy programmer who would actually run the new channel, has not.

Really, though: Why would Rupert do this? Is there a business case for another business channel?

MURDOCH
A history of trusting his gut and betting big

DOW 12,000 ASIDE, this is not a moment when business mania is crossing over to the mainstream. Business media remains a destination around which a desirable and affluent audience gathers, but both print and television have suffered since the dot-com bust. TNS Media Intelligence—with the best estimates available, since NBC Universal does not break out its results—shows a truly impressive decline in ad revenues for reigning business cable player CNBC. Ad revenues topped $500 million in 2002 and were at $313.8 million last year. But the beauty of the cable business is that it features two revenue streams, one from ads and one from subscribers. CNBC is in around 90 million homes, and, according to an individual familiar with the numbers, looks likely to post its most profitable year in '06, with net topping $275 million. To put that into perspective, last year total NBC Universal profits were around $3.7 billion. "CNBC still enjoys the exclusive status as the sole all-business channel," says John Rash, senior vice-president at ad agency Campbell Mithun. It has since CNNfn disappeared in late 2004.

So it looks like the money is there. And all the more so should Fox expand on the focus of CNBC and "Fox-i-fy" the programming in ways that CNBC's screaming head Jim Cramer might not even recognize. Is it a good idea? Well, it is curious that Ailes has been much shier than his boss about this, since he is the guy who launched CNBC in the first place. He may be remembering tha CNNfn didn't secure a critical mass of cable subscribers at launch and be leery of talking as loudly as his boss with so few deals in place.

It is still early days for a potential Fox business channel. Yes, the digital service would allow Fox to reach about half of Comcast's 24 million total subscribers. B a spokeswoman for Cox Communication the third-largest cable operator in the lar said that her company had yet to have ar discussions with Fox over such a channe Over at Time Warner Cable, the second-largest in America and one holding the key to the crucial Manhattan market, a spokesperson confirmed ongoing "active negotiations with Fox," but would not specify what those discussions entailed. Still, in key corners of the cable industry, Fox's entrance into the category at some point next year is expected, even if Murdoch has to pay the cable guys in a big way to get the channel on the air. "Fox has sent signals to th ad community that a Fox business channel is coming, date t be determined," says Rash.

Murdoch's current status as the one media mogul who h it all figured out is bound to be dented sooner or later. But, faced with the choice of betting on Murdoch's confidence o Ailes's reticence, I'll place my money on Rupert.

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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BY JAMES C. COOPER

Strong Labor Markets Put the Fed on the Spot

Weak productivity and rising labor costs could force more rate hikes

U.S. ECONOMY Productivity growth was Alan Greenspan's best friend, but it might be turning into Ben Bernanke's worst enemy. In the late 1990s big gains in corporate efficiency—compelled by global competition and enabled by new technologies—were the key factor that held down inflation. The three years ending in 1999 saw productivity gains accelerate, on average, at a pace of 2.8% annually, up from a rate of 1.4% the previous three years. That speedup allowed the economy to grow strongly and at unusually low rates of unemployment, without causing the kind of price pressures the Greenspan Federal Reserve would have had to beat down by jacking up interest rates.

What a reversal. As of the third quarter, the three-year growth rate of productivity has slackened dramatically, from a peak rate of 4% per year in 2003 to only 1.9%, the lowest in nine years (chart). The Labor Dept.'s latest report shows that third-quarter productivity, measured as output per hour worked, posted no gain from the second quarter, and was up a meager 1.3% from the previous year. Even that pace is set to be revised downward early next year, when Labor incorporates a recent data revision showing Americans worked more hours at more jobs from March, 2005, to March, 2006.

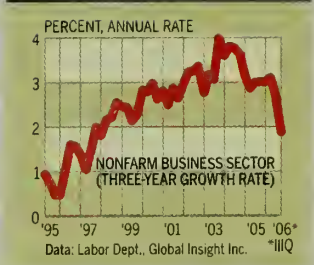
THIS TURNABOUT THREATENS to create a thorny problem for the Bernanke Fed. The productivity slowdown means the economy has less room to grow without generating inflation than it did in the late '90s and early this decade. That is becoming especially clear in the labor markets, which continued to tighten in October even as economic growth slowed. The result: All major gauges show labor costs picking up at a time when most companies' productivity gains are too weak to offset them. Historically, such cost pressures have found their way into higher prices.

Those pressures come from unit labor costs, or pay adjusted for gains in productivity. If a company can offset a pay raise with an equal increase in productivity, the cost of making each product, or unit, doesn't change. But if the unit cost rises, then its price must increase, or profits get squeezed.

The Fed's predicament: If economic growth picks up after its midyear slowdown, which looks likely, the labor markets will tighten further and inflationary pressures will keep building. The Fed's benchmark price index (which gauges increases from a year ago) is already running above the policymakers' favored 2% limit. In such a situation, the Fed's hopes for slower growth that would combat inflation would fade. Policymakers would be left with little recourse but to resume hiking rates, and that could put the financial markets, housing, and the economy at risk later in 2007.

FOR NOW, WALL STREET and many economists are convinced that Fed policy will remain on hold for a long time. But the job markets' surprising strength in recent months casts doubt on that outlook. While economic growth slowed to an average annual pace of only 2.1% in the middle two quarters, unemployment still fell from 4.7% in March to 4.4% in October, a 5½-year low. The job data indicate that, without an extended period of sluggish growth, potential inflation pressures from the labor markets will continue to build.

PRODUCTIVITY GROWTH TAKES A DIVE



Data: Labor Dept., Global Insight Inc.

By any measure, the growth in unit labor costs is speeding up. The question is, how fast? Several Fed officials have downplayed the cost data in the Labor Dept.'s third-quarter productivity report, because its measurement of labor compensation appears to have been exaggerated earlier this year by one-time bonus payments and exercised stock options. This measure shows unit labor costs last quarter grew 5.3% from the previous year, the fastest pace since 1990 and twice as fast as a comparable measure of prices. But if that were true, corporate profits would be getting shellacked right now, and that's not happening.

In fact, according to Thomson Financial, with 407 of the Standard & Poor's 500-stock index companies having reported, third-quarter earnings are heading toward an average increase of more than 18% from the previous year. Of the reporting companies, some 73% have announced higher-than-expected earnings,

far above the 60% average since 1994.

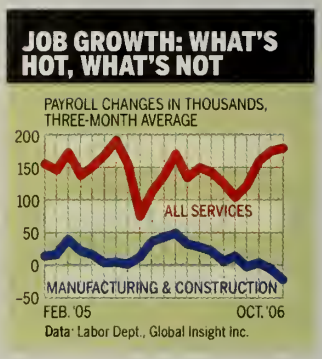
Still, other measures of workers' pay are also growing faster. Average hourly earnings of production workers rose strongly last month, and for the three months ended in October, hourly pay is up 4% from the year before. This time last year, the annual pace was 2.8%.

Even the quarterly employment cost index (ECI), which includes wages and benefits, is beginning to pick up. Many economists and Fed officials follow the ECI, saying it is more stable and adjusts for the changing mix of high- and low-paying jobs. Yearly growth in the ECI slowed from early 2004 to early 2006, from 3.8% to 2.8%. But in the last two quarters its growth quickened, to 3.3% in the third quarter, the fastest in a year and a half. So even by this measure, with lower productivity, unit labor costs are rising faster than before.

FED POLICYMAKERS COULD rest easy if only there was sufficient evidence that the economy would, for some time, remain as meek as it was in third quarter, when it grew at an annual rate of only 1.6%. That would justify hopes that the labor market's tightness would ease, at least enough to alleviate inflation concerns. It just doesn't seem to be happening. Businesses are still expanding to meet growing demand, and their new hires are earning plenty of income to spend. Both businesses' capital spending and consumers' purchases show every sign of growing faster this quarter than they did in the third.

Job growth since March, which covers the slowdown period, has averaged 134,000 new slots per month, thanks partly to large upward revisions to the data on job growth for August and September. That pace, if sustained, is brisk enough keep downward pressure on the unemployment rate, preventing any easing in labor-market conditions.

Moreover, the job data show that the midyear slowdown was confined to construction and manufacturing (chart). Gains in service-sector payrolls—more than fou fifths of all jobs—sped u in recent months. Clearl there is more weakness to come in housing and factories, as both sectors work through bloated inventories, especially the auto industry. That all will require further production cutbacks in the coming months. But signs still point to continued strength elsewhere more than offsetting those soft spots.



The key question Fed officials must grapple with is this: Is the unemployment rate already low enough to create ever-rising pressure on wages and prices? Right now, the Fed expects an economic slowdown sufficient t generate enough slack in the labor market to allow price pressures to ease. But with productivity growth fading and the jobless rate still falling, policymakers are bound to get increasingly uncomfortable with the way the inflation outlook is shaping up. ■

MANUFACTURING

What's Piled Up Must Come Down

THE U.S. ECONOMIC slowdown has left manufacturers with stockpiles of unwanted inventory. These excesses mean the current stretch of tepid industrial activity will run a bit longer. But prospects for the new year look much better.

Partly reflecting a steep 3.5% drop in September factory shipments, September inventories are up 7.5% from the previous year, the fastest annual advance since April, 2005. The ratio of inventories to shipments, which measures how long it would take to sell off stockpiles at current sales rates, jumped to a three-year high of 1.22 months (chart). As companies work through that backup, factory output and payrolls will remain depressed.

The sharp drop in housing activity and languishing sales among U.S. auto producers are at the heart of the weakness. With homebuilders scaling back, construction machinery shipments plunged in September, while inventories jumped. Auto inventory growth accelerated in September, reaching a yearly pace of 11.3%, according to the Bureau of Economic Analysis.

Inventory is also building up in areas including metals and computer equipment. This is probably why the Institute for Supply Management's October factory activity index showed 19% of respondents—the largest share in over five years—believed customer inventory levels are "too high."

If businesses cut back investment spending on a larger scale, or if the housing market drags down consumers, manufacturers would face a rocky road. But consumer spending remains strong heading into the fourth quarter, and the third-quarter industry survey by the National Association for Business Economics showed a rebound in capital-spending plans for next year Those results are backed up by the solid September increases in new a unfilled orders for capital equipmen

In the coming months, the mix o strong demand and production cuts should eliminate excesses and clear the way for a reacceleration in outpu growth early next year. ■

–By James Mehring in New Yo

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The Business Week

News you need to know

EDITED BY HARRY MAURER

The Voters Speak Less than 12 hours after Republicans lost control of the House—and perhaps the Senate—in a stinging midterm defeat, **President George W. Bush** on Nov. 8 announced the resignation of **Defense Secretary Donald Rumsfeld** (photo), chief architect of the war in Iraq. Bush said his choice to replace Rumsfeld, former **CIA Director** and current **Texas A&M University President Robert Gates,** would bring "fresh eyes" to management of the war. Voters cited Iraq as the main reason for turning the GOP out.

For business, the election offers hope for bipartisan deals on such top priorities as immigration reform, R&D tax credits, higher spending for education, and measures to shore up company pensions. But aggressive Democratic oversight hearings could take aim at Republican-leaning industries such as pharmaceuticals, energy, insurance, and defense. A Democratic Hill also is unlikely to O.K. further curbs on lawsuits or make Bush's tax cuts permanent.

See "Taking control," page 34, and ONLINE *"What the election means for business," www.businessweek.com/go/tbw*

FedEx Changes Planes On-time delivery is the soul of FedEx' business, and apparently it wants the same treatment. Saying it couldn't wait an extra two years for **Airbus'** delay-plagued **A380** megajet, the package titan on Nov. 7 grounded its 10-plane order and agreed to buy $3.5 billion worth of **Boeing 777** freighters instead. Some industry watchers say the decision could spur other cancellations. On Nov. 8, Airbus parent **European Aeronautic Defence & Space** posted a $305 million third-quarter operating loss because of the production snafus.

A Deluxe Hotel Bid Maybe they have fond memori of perfect pillows. On Nov. 6 a group including **Saudi Prin Alwaleed bin Talal** and **Bill Gates** offered $3.7 billion to take **Fo Seasons Hotels** private. The group also features founder **Is dore "Izzy" Sharp,** who controls most of the voting shares a said no other bid would be considered. The Toronto luxu chain manages more than 70 inns worldwide. But why p a 28% premium for a company that takes little equity in properties? Brand power, of course, and a bet that the ho industry's upswing has a long way to go.

ONLINE *See "Barring the door at the Four Season www.businessweek.com/go/t*

VW's New Driver In May they extended his contr through 2012. On Nov. 7 they booted him out. Well, boa can change their minds, and **Volkswagen's** sure did, ousti **CEO Bernd Pischetsrieder,** 58, who will step down at yeare The move, seen as orchestrated by mercurial and pric **Chairman Ferdinand Piëch,** took investors and employees surprise. VW is in the midst of a difficult restructuring lower labor costs, expand its lineup, and tune up qual Pischetsrieder will be replaced by **Martin Winterkorn,** 59, he of VW's **Audi** unit. Meantime, as widely expected, **Jean-Ma Folz,** longtime CEO of **PSA Peugeot Citroën,** said he would g way to **Christian Streiff,** 52, former co-head of **Airbus.**

ONLINE *See "Pischetsrieder crashes at VW www.businessweek.com/go/t*

Happy Holidays on the Street Surprise: Wall Str pay envelopes are getting even fatter. Compensation c sultant **Johnson Associates** reported on Nov. 7 that yeare cash bonuses and equity awards would jump 10% to 1 over last year. Investment bankers will pocket 20% mo That means the average managing director at a big inve ment bank will take home $1.7 million during the holida and superstar traders will collect as much as $40 millio

Web Watch As video continued to wheedle its w into new media, **Google** pushed hard into an old one. Nov. 7, **Microsoft** announced plans to offer pay-per-v movies and TV to its 4 million **Xbox Live** subscribers. **Veri** is negotiating with **YouTube** to bring its user-submit videos to Verizon's cell phone and TV service subscrib according to *The Wall Street Journal.* And Google, wh recently agreed to buy YouTube, launched its most am tious print-ad program to date. After moving into radio magazines in the past year, Google is now letting adver ers place bids for space in more than 50 U.S. newspape

ONLINE *See "Google's new frontier: Print a "Showtime for the Xbox 360," and "Verizon may s YouTube videos," www.businessweek.com/go/*

Merrill Gets a Letter Newly added to the list of buy firms under federal scrutiny: **Merrill Lynch Global Private Eq** A Merrill spokesman had no comment, but the comp isn't alone. The **Justice Dept.,** which is thought to be pok into possible anticompetitive behavior in the high-fly world of private equity, has also sent letters to **Carlyle Gr**

layton, Dubilier & Rice; Kohlberg Kravis Roberts; and **Silver Lake artners.** A source familiar with the letters says Justice hasn't gnaled whether it's examining any particular deal.

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oyota Terrific The earnings gap between Detroit's Big hree and Toyota has become a chasm. On Nov. 7 the Japaese carmaker posted quarterly net income of $3.5 billion, rise of 33.6% on a year earlier, for the three months ended ept. 30. The key factors: a revved-up North American biz nd a weaker yen. For the same period, **GM, Ford,** and **DaimrChrysler** unit **Chrysler** posted combined losses of $7.4 billion. oyota also raised its full-year operating profit outlook by 2 billion, to $13.2 billion, which would set a record for a panese company.

ONLINE *See "Toyota: Still accelerating," www.businessweek.com/go/tbw*

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olling for Toll Brothers In the latest sign that the ousing slump is far from over, luxury homebuilder Toll rothers said on Nov. 7 that orders for new homes fell 56% its Oct. 31 fiscal quarter from a year earlier. And things uld get worse. **CEO Robert Toll** commented: "We continue look for signs that a recovery is imminent but can't yet y that one is in sight."

ONLINE *See "How deep housing's decline?" www.businessweek.com/go/tbw. com*

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ivendi Flirts with KKR You can't fault the private uity crowd for lack of ambition. On Nov. 4, French entrtainment and telecom group Vivendi confirmed it had ndered a $50 billion takeover by **Kohlberg Kravis Roberts,** in at would have been the biggest leveraged buyout in hisry. Vivendi said its talks with KKR went nowhere, but the sclosure raised the question of whether it's in play.

Dire Prediction of the Week

Ve all know **China** is environmentally challenged, but his makes it clear just how challenged. The **International nergy Agency** on Nov. 7 issued a report that forecasts China will overtake the U.S. as the biggest emitter of the nain greenhouse gas, carbon dioxide, by 2009, because f heavy reliance on high-sulfur coal. Already, Chinese ities rank among the worst in terms of air pollution, and cid rain is a scourge across nuch of the country. Some 0% of the population lives n severely polluted areas, nd 70% of Chinese rivrs and lakes are in grim hape, environmental reguators concede. Yet China's eveloping-nation status eaves it untouched by the **Kyoto Protocol's** emissions tarets, and Beijing points the finger at wealthy countries s the main global-warming perpetrators. Talks begin on Iov. 13 to figure out the next step after Kyoto.

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ELECTION 2006

THE POLITICS OF CHANGE

As power shifts on Capitol Hill, business faces a new reality

BY RICHARD DUNHAM AND EAMON JAVERS

BY HISTORICAL STANdards, the Democratic landslide of 2006 was well within the norm: In the sixth year of an Administration, the average loss for a President's party in midterm elections is about 29 House seats, and 6 Senate seats. But for a shell-shocked White House and a business community that bet heavily on the Republicans, the GOP reversal of fortune on Nov. 7 was anything but normal.

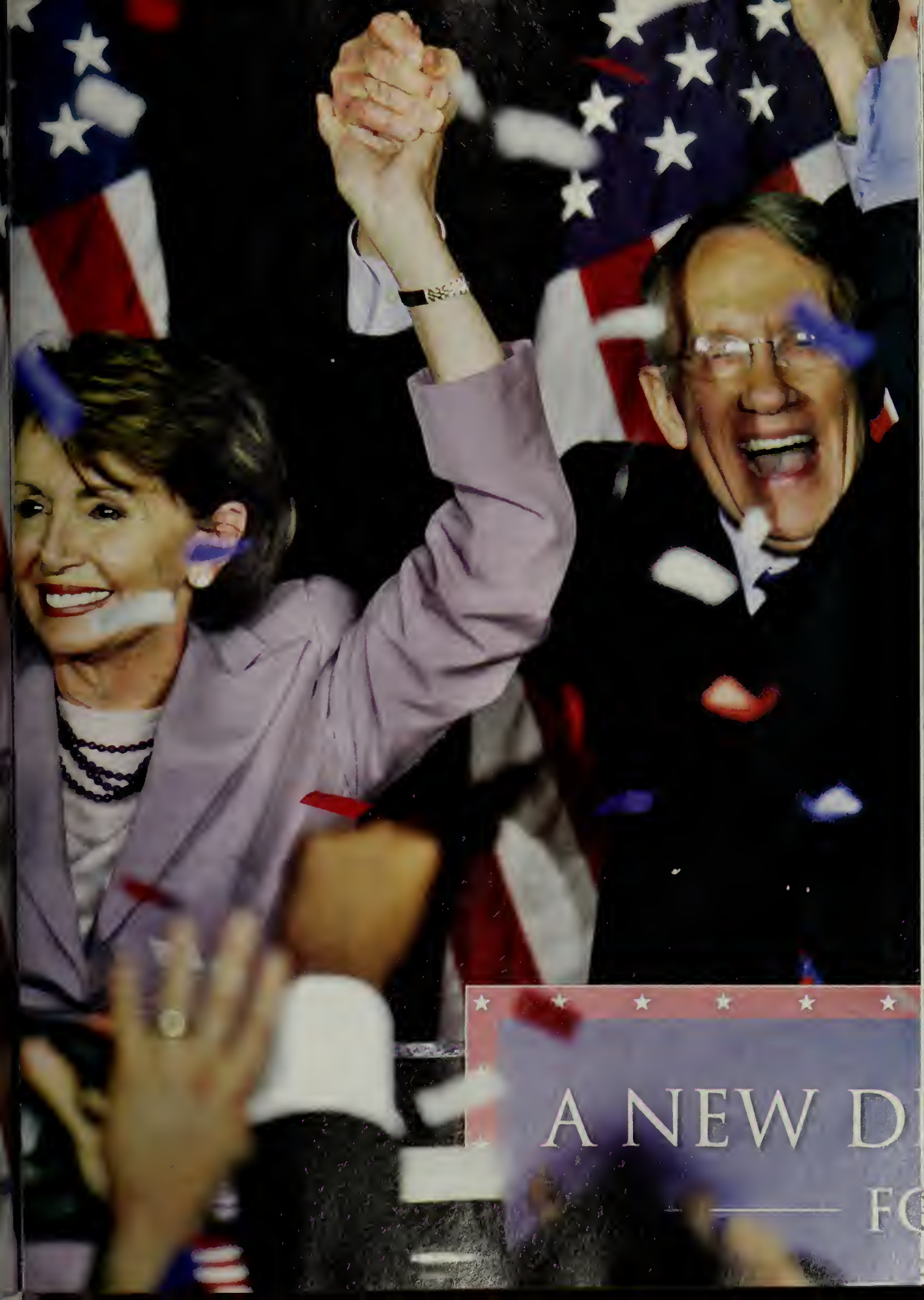
Having forged close ties with Republicans on Capitol Hill and funneled about two-thirds of corporate campaign contributions to the GOP, business faces a rude awakening after Democrats swept to victory in the House of Representatives and drew within striking distance in the Senate. As *BusinessWeek* went to press on Nov. 8, Democrats had captured at least 27 Republican House seats, far more than the 15 they needed to regain control for the first time in 12 years and make liberal Representative Nancy Pelosi of California the first female Speaker of the House. (Five were still too close to call, and two appeared headed to runoffs.) Democrats also took back the Senate by the narrowest of margins, 51 to 49, as challenger Jim Webb eked out a razor-thin victory in Virginia over Republican Senator George F. Allen, once talked of as a possible Presidential candidate.

The anti-Bush tide swept away several close allies of business. Among them: Representative Jim Leach of Iowa, former chairman of the panel then known as the House Banking Committee; 12-term House Ways & Means Committee stalwart Nancy L. Johnson of Connecticut; and House Resources Committee Chairman Richard W. Pombo of California, the scourge of the environmental movement. In the Senate, moderate Lincoln Chafee of Rhode Island, who prevailed in a bitterly contested GOP primary with strong business support, was toppled by Democrat Sheldon Whitehouse, the state's former Attorney General.

Business has little choice but to adapt to a reshaped Washington. "If I were the ultimate decision-maker for American industry," says Democratic business lobbyist Ben Barnes, "I would call Nancy Pelosi and say, 'I want to help you be a good Speaker.'

PELOSI AND REID Will Dem leaders preside over gridlock?

J. SCOTT APPLEWHITE/AP PHOTO


A NEW D
FO

BIPARTISAN PARTNERS Democrat Baucus and Republican Grassley

Business leaders would be shocked at how much influence they could have by talking to Democrats about jobs in their districts and the Little League teams they are sponsoring."

BACK TO THE CENTER

THERE'S NO DOUBT that the party's over for business. But it's not simply because the days of corporate lobbyists writing Republican legislative proposals have come to an end with the ascendancy of such left-leaning committee chairs as Charles B. Rangel of New York (Ways & Means), Barney Frank of Massachusetts (Financial Services), and John D. Dingell of Michigan (Energy & Commerce). Partisan affiliation itself will matter less in a Washington where the chambers of Congress are narrowly divided between the parties and President George W. Bush maintains veto power over anything he considers runaway liberalism on Capitol Hill. Senator Hillary Clinton (D-N.Y.) declared in her Nov. 7 victory speech that the election would propel policy "back to the vital, dynamic center."

Centrist players from both parties who are likely to build coalitions that supersede partisan agendas could emerge as new power brokers—and targets for business lobbying. Among the newly empowered centrists are Senator Tom Carper (D-Del.) and Senators Olympia J. Snowe and Susan M. Collins, both Republicans from Maine; Representative Christopher Shays (R-Conn.); and Representative Ellen O. Tauscher (D-Calif.), chair of the moderate New Democrat Coalition, who worked on Wall Street for 14 years and was one of the first women to hold a seat on the New York Stock Exchange. While several Republican moderates went dow to defeat, the ranks of bipartisan centris expanded with victories by about a doze business-backed Democrats, includir Representative-elect Gabrielle Giffor (D-Ariz.), the managing partner of property management firm, and Tim M honey (D-Fla.), co-founder and chairm of vFinance Inc., a venture-capital firm

But just because a lawmaker is l beled a moderate doesn't mean he's a economic moderate. Senator-elect B Casey Jr. (D-Pa.), for example, is co sidered a centrist because he is a soci conservative, but he is a liberal populi on economic issues. Still, in a narrow divided Democratic House, Tauscher band of about 40 economic moderat could wield extraordinary power to infl ence tax, trade, and budget policy. "The are a lot of pro-business Democrats says Tauscher. She says her group is wi ing to work with the White House, but has been ignored for years. "They do call," she complains. "They don't wri They don't send flowers."

That could change. One former Bu Cabinet member, ex-Secretary of Hom land Security Tom Ridge, predicts th the President will work across party lin to avoid two years of complete gridlo on economic issues from deficit reducti to taxes. "He has no choice," says Rid "He'll have to reach out if he wants to g anything done."

Even in the middle of the harsh pa tisanship of recent years, certain co mittees on Capitol Hill have maintain good bipartisan working relationshi Among them are the House Financ Services Committee, the House Ener & Commerce Committee, and the Se ate Banking Committee. On the Sena Finance Committee top Democrat M Baucus (D-Mont.) and senior Republic Charles E. Grassley (R-Iowa) are clo friends and political collaborators.

That bipartisanship is expected to co tinue even with Democrats in charge. T committees could make progress in t next two years on such issues as raisi the minimum wage, reforming immig tion law, and protecting retailers a consumers from identity theft. On t Senate Health, Education, Labor & Pe sions Committee, Democrat Edward Kennedy (Mass.) and Republican Mich B. Enzi (Wyo.) are working on bipartis legislation that would allow smaller co panies to lower pension costs.

To break through to the new Dem cratic leaders, companies will be rushi

Washington's Revised **Rules** of the Road

1 THE PARTY'S OVER To get laws enacted in a new era of divided government, partisan politics will likely play less of a role. Look for centrist Republicans and Democrats to link arms to guide the legislative agenda.

2 COMMITTEE CHAOS Certain committees, such as House Ways & Means and Judiciary, have long been known for partisan bickering. Little is likely to change under the Democrats. The Senate Finance Committee and the House Financial Services Committee are far more collegial and may be the places business goes to get things done.

3 BEYOND THE HILL Business and industry lobbyists will increasingly take their concerns to regulatory agencies or the states — where they are likely to get more favorable results — than to Capitol Hill.

Swing **Shift**

Key Figures, Groups, and People in the Midterm Elections

New vs. Old

U.S. Chamber of Commerce
Ratings for Democratic vs. Republican Chairmen *

HOUSE COMMITTEE	NEW DEMOCRAT	RATING	OUTGOING REPUBLICAN	RATING
Financial Services	Barney Frank	**33%**	Michael Oxley	**92%**
Ways & Means	Charles Rangel	**38%**	Bill Thomas	**96%**
Small Business	Nydia Velazquez	**48%**	Donald Manzullo	**93%**
Energy & Commerce	John Dingell	**52%**	Joe Barton	**92%**
Budget	John Spratt	**52%**	Jim Nussle	**93%**

* Ratings are based on how often lawmakers' votes on business issues are in line with the Chamber's position.

Five Biggest Contributors

To the GOP

	AMOUNT (MILLIONS, ROUNDED TO NEAREST $10,000)
National Beer Wholesalers Assn.	**$1.52**
AT&T	**$1.46**
National Association of Realtors	**$1.41**
National Association of Home Builders	**$1.35**
United Parcel Service	**$1.30**

Speaking of...

ook at the interest groups that contributed the most to the outgoing and incoming Speaker of the House during the 2006 election cycle.

DENNIS HASTERT (R-ILL.)

INTEREST GROUP	AMOUNT
1. Securities & Investment	**$267,950**
2. Health Professionals	**$178,950**
3. Retirees	**$167,500**
4. Pharmaceuticals/Health Products	**$144,500**
5. Real Estate	**$140,800**

NANCY PELOSI (D-CALIF.)

INTEREST GROUP	AMOUNT
1. Securities & Investment	**$93,000**
2. Real Estate	**$81,300**
3. Transportation Unions	**$78,000**
4. Building Trade Unions	**$75,000**
5. Lawyers/Law Firms	**$74,050**

Five Biggest Contributors

To the Democrats

	AMOUNT (MILLIONS, ROUNDED TO NEAREST $10,000)
International Brotherhood of Electrical Workers	**$2.12**
Association of Trial Lawyers of America	**$2.01**
Emily's List *	**$1.68**
Goldman Sachs	**$1.60**
American Federation of State, County & Municipal Employees	**$1.55**

* A grassroots organization that backs pro-choice Democratic women for public office.

Business-Bred

Some of the new members who have a business background

NAME	SEAT	LINE OF BUSINESS	FORMER OCCUPANT
Bob Corker (R)	Tennesee, Senate	Construction	Bill Frist (R) (retired)
Gabrielle Giffords (D)	Arizona 8th, House	Property Management	Jim Kolbe (R) (retired)
Tim Mahoney (D)	Florida 16th, House	Venture Capital	Mark Foley (R) (resigned)
Heath Shuler (D)	North Carolina, 11th, House	Real Estate	Charles Taylor (R) (defeated)

Political Action Committee Contributions

	TOTAL	DEMOCRATS	GOP
Business PACs:	$693.4 million	$299.1 million	$311.2 million
Labor PACs:	$44.1 million	$37.8 million	$5.9 million

Data: Center for Responsive Politics, U.S. Chamber of Commerce, *BusinessWeek*

Total 2006 Campaign Contributions
$2.8 billion

to stock up on lobbyists with Democratic credentials. But not all Democrats are created equal. In the influence-peddling world, the most important thing is personal relationships with key players on Capitol Hill. That could make Nancy Pelosi's former chief of staff, George Crawford, a K Street superstar. In recent months, he has added Exxon Mobil Corp. and Amgen Inc. to his client roster.

There's also a ready source of well-connected talent in the roster of former Democratic lawmakers with close ties to the leadership, including ex-Representatives Thomas J. Downey of New York and Marty Russo of Illinois. But savvy businesses won't ditch Republican lobbyists altogether. Some, like former House Appropriations Committee Chairman Robert L. Livingston Jr. (R-La.), have close ties to suddenly powerful Democrats, too.

AWAY FROM THE HILL

BUSINESS ADVOCATES point out that there's yet another way to connect with newly minted Democratic leaders: get involved with a lawmaker's favorite charity or pet project. The Financial Services Committee's Frank is interested in creating incentives for building affordable housing. Ways & Means' Rangel, whose district includes Harlem, is devoted to trade with Africa and urban development in the U.S.

On the Senate side, Democratic Leader Harry Reid of Nevada has a deep interest in suicide prevention. A group of lobbyists and industry organizations helped raise money for the 2005 Suicide Prevention Action Network dinner on Capitol Hill, which honored Reid, whose father killed himself in 1972. The potential payoff from such gestures, says one Republican lobbyist familiar with the event, is that "you can get a member of Congress to say, 'Oh, that guy really cares about me.' It won't get your bill passed, but it helps on the margins."

Companies that are on the ball politically will also turn away from Capitol Hill to get certain things accomplished. With Congress closely divided and likely to deadlock on many key issues, business will focus more attention on federal regulatory agencies and state governments. One prime example: litigation restrictions. Incoming House Judiciary Committee Chairman John Conyers (D-Mich.) is unlikely to allow any additional limits on lawsuits to emerge from his panel. So business groups will redouble their tort-reform efforts in state legislatures.

In the telecommunications industry, the Baby Bells have come to the conclusion that a Democratic House will stymie their attempts to win the ability to provide pay-per-view video services without certain regulations that they strongly oppose. Instead of fighting a losing battle in Washington, one industry representative says the telephone companies will target major states for a new lobbying push. "It's not easy going state-by-state, but it makes sense if it's the only way to g what you want," says a lobbyist wor ing on the issue.

Even in Washington, there will more action away from the Capit Seeking to curb the more onerous r porting requirements imposed by t Sarbanes-Oxley law, some business may head for the Securities & Exchan Commission and the Public Compa Accounting Oversight Board (PCAO instead of congressional committees. can all be done with the stroke of a p at the SEC or PCAOB," says one financ services lobbyist, "and we don't ev have to go to the Capitol." ■

Bull's Eye

Certain industries, especially those with ties to the Bush-Cheney Administration, are likely to be targets of probes by empowered Democrats.

WAR AND DISASTER CONTRACTORS

Fraud and waste in Iraqi reconstruction will be the focus of hearings chaired by Representative Henry Waxman (D-Calif.), who is in line to lead the House Committee on Government Reform. Halliburton, once headed by Cheney, will be in the spotlight. The Hurricane Katrina cleanup will also receive scrutiny.

OIL AND GAS PROVIDERS

Democrats have indicated they will drill down on energy companies that they say have not been paying sufficient royalties to the government for oil and gas extracted from federal lands.

PHARMACEUTICAL MANUFACTURERS

Presumptive Speaker Nancy Pelosi (D-Calif.) argues that Republicans have given drug companies a sweetheart deal in the Medicare prescription drug plan. She plans to probe this arrangement with an eye toward slashing how much the government pays for prescription drugs for seniors.

The New Tax Picture

Where Congress is headed on key tax issues

INCOME TAX

Throughout the fall campaign, Democrats have said they want to pare back or eliminate tax cuts for the wealthiest Americans, while preserving reductions for middle-class and low-income families.

AMT

Charles Rangel (D-N.Y.), soon-to-be chairman of the House Ways & Means Committee, will make reform of the alternative minimum tax a top priority. One reason: The AMT happens to hit New Yorkers particularly hard.

CAPITAL GAINS

Although Bush's capital-gains cuts don't expire until 2010, they could come into play if Democrats try to use projected savings from rolling back the cuts to fund current pet projects.

ESTATE TAX

With Democrats in control of the House, wave goodbye to the proposed total repeal of the estate tax. One possible compromise: spare more modest estates, making only the wealthiest subject to the tax.

STUDENT LOANS

Democrats have promise to make higher education more affordable and have suggested making student loans tax deductible. Another idea renewing research and development tax credits for companies.

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TROUBLE AHEAD New residents are soon dogge by phone and mail offers

MORTGAGES

HABITAT FOR HUSTLERS

Freewheeling banks and lenders are preying on owners of the affordable homes

BY MARA DER HOVANESIAN

THE GUIDING PRINCIPLE of the nonprofit Habitat for Humanity, founded in 1976 to build affordable houses for underprivileged families, comes from the Old Testament: "If a brother living near you becomes poor, you must provide for him...do not make a profit on the goods you sell him." But that ethos doesn't carry over to the many banks, brokers, and mortgage servicing companies that deal with Habitat families and, increasingly, are profiting handsomely from the financially naive.

Consider it another consequence of the housing boom. Habitat families are able to buy their homes for much less than full market value. A decade of rising prices has made them wealthier—on paper. At the same time, many are strapped for cash and unsophisticated about credit. For freewheeling brokers and lenders eager for refinancing business, the combination couldn't be better. "Habitat borrowers have targets on their backs," says Michael Calhoun, president of the Durham (N.C.) Center for Responsible Lending.

Charles and Ann Williams of St. Paul, Minn., are prime examples. He's a janitor, she's a home child-care provider, and they have three children. Their annual income is $18,187, supplemented by Social Security benefits. In 1995 they built a Habitat house and took a $64,000 mortgage. Since all original mortgages in the Habitat program are interest-free, their monthly payment was just $396.

That changed last year. A flyer advertising an offer to refinance with New Century Financial Corp. in Irvine, Calif., looked tempting. Within three weeks the couple signed papers. The good news was that they were able to unlock $28,000 in equity, money they used to cover debts. But their new $81,000 loan carries an interest rate of 9% and payments c $872 a month, more tha half their monthly incom And the loan's adjustab rate can jump to 16% in tw years. New Century says has policies to ensure bo rowers know what they' getting into and that it negotiating with the coup for a new loan on bett terms. The Williamses d clined comment.

Many other families a being bombarded with o fers to refinance out of 0 loans. Jordan Ash, direct of the Financial Justice Center at the A sociation of Community Organizatio for Reform Now, an advocacy group, sa lenders are targeting Habitat famili with phone calls, mailings, and eve personal visits. Habitat affiliates in Indi napolis and Columbus, Ohio, say ma clients are getting mail solicitations th look to be from Habitat but are not. probably get two phone calls a week says Dawn Daniels-McNear of the C lumbus affiliate.

LIMITED FOCUS

FAMOUSLY CHAMPIONED by emissa Jimmy Carter, Habitat is a $145 millio a-year enterprise based in Americus, G with about 2,300 affiliates in some 1 countries and all 50 states. It builds nea ly 25,000 homes a year for people w earn 25% to 50% of their area's medi income. Applicants contribute about weeks of labor to build their home or o ers in the community, make a downpa ment of $100, and commit to a mont mortgage payment.

Habitat's focus is mainly on buildi Most of the mortgage payments it colle go into a pool to fund more houses. B Habitat also sells scores of loans to ba and outsources to mortgage service some of which impose draconian pen ties if people fall behind. They "jam pre atory costs and attorney's fees and inter at 18% into the debt," complains A Carrie Charney, a lawyer with Jacksonvi

Hammered

Lenders are taking advantage of Habitat owners in two main ways:

REFINANCING	SERVICING
They are tempting families to unlock equity by refinancing—at sharply higher interest rates	High late-payment penaltie and other fees are sending some families to the brink c foreclosure

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†Source: Morningstar 9/30/06. For each fund with at least a 3-year history, Morningstar® calculates a risk-adjusted return measure that accounts for variation in a fund's monthly performance (including the effects of all sales charges), placing more emphasis on downward variations and rewarding consistent performance. The top 10% of funds in each category receive a Morningstar Rating™ of 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. (Each share class is counted as a fraction of one fund and rated separately.) The fund was rated against 406, 320 and 145 funds and received Morningstar Ratings of 3, 4 and 4 stars for the 3-, 5- and 10-year periods, respectively. Morningstar Rating™ is for Class A shares only; other share classes may have different performance characteristics. ©2006 Morningstar, Inc. All rights reserved. The information contained herein is proprietary to Morningstar and/or its content providers; may not be copied or distributed; and is not warranted to be accurate, complete, or timely. Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information.

Area Legal Aid Inc. in Jacksonville, Fla.

One of Charney's clients is Yolanda Ray Cotton, who bought a home in 2000. When she slipped on payments, the loan's servicer, EverBank Financial Corp., quickly raised fees and threatened foreclosure. Cotton refinanced with Option One Mortgage Corp., a unit of H&R Block Inc. specializing in loans to borrowers with poor credit. Now she's behind on that loan, has racked up $9,925.65 in penalties, and is fighting to stave off foreclosure, says Charney. Cotton declined to comment. Option One says it is investigating the loan and will offer remedies if appropriate.

Critics say Habitat, which is made up of autonomous affiliates, isn't set up to deal with homeowners' problems. In many cases, "Habitat makes the loan, and they're out of the picture," says Charney. Spokesman Duane Bates says Habitat is aware of the problems with predatory lenders and servicers but doesn't consider them widespread. He notes that foreclosures are rare, with the national rate under 2%. And he says Habitat offers education and training to help owners make better choices.

Habitat tries to warn owners away from refi deals

Habitat also says it's beefing up borrower protections. Some newer loans require homeowners give Habitat the right of first refusal to buy the house for the amount paid in. Others stipulate that owners can collect only a percentage of the profit from a sale or refinancing based on how long they've lived there; the rest goes back to Habitat.

Even so, refis still tempt families who don't realize how fast the fees and interest add up. "You can't get a better deal than 0%. There's absolutely no reason to refinance," says Chris Miller, senior vice-president for loan servicing at NovaStar Financial Inc. in Kansas City, Mo. The firm has launched a pilot program with Habitat to provide mortgage servicing, job counseling, and credit education for free. Miller says many customers come for advice about refinancing, unschooled in the basics and unaware that they currently pay no interest. He says his team dissuades only 35% of them from refinancing. "Lenders are taking advantage of them," Miller says. "It defeats the entire purpose of the program."

–With Greg Hafkin in New York and Christopher Palmeri in Los Angeles

DEALS

ALL THAT MONEY HAS TO GO SOMEWHERE

Cheap rates and buyout firms awash in cash are fueling a boom in mergers

BY ROBEN FARZAD

NOTHING STIRS THE STOCK market's animal spirits like a mergers-and-acquisitions boom. On Nov. 6 the Dow Jones industrial average rose 120 points as investors cheered buyouts valued at more than $20 billion, all priced at a premium.

The excitement actually began on Nov. 4, when it was revealed that buyout firm Kohlberg Kravis Roberts & Co. had approached entertainment giant Vivendi with a $50 billion bid—a deal that would have dwarfed all leveraged buyouts in history. With the buzz lingering, 10 major deals popped up two days later, including the buyouts of Four Seasons Hotel, Outback Steakhouse parent OSI, and a German forklift manufacturer. The flurry was a continuation of a trend: In the first week of November, deals totaling $99 billion were announced, up from a first-week average of $66 billion during the previous 10 months.

Why the uptick? Start with interest rates. The yield on the 10-year Treasury note has dropped to 4.65 from 5.25 since June, giving LBO firms, already flush with cash, even more buying power. "Deals have become a lot more interesting from a leverage perspective," says Jeffrey N Kleintop, chief investment strategist c PNC Wealth Management. Glover H Lawrence, managing director of Bosto M&A advisory firm McNamee Lawrenc & Co., says private-equity buyers a constantly asking him what he's workin on—and reminding him to "keep the on the radar." "They're eager to spen all the billions they've raised," he say "They get paid to put money to work."

Falling rates spur corporations to g shopping, too. That's because they si nal expectations of an economic slov down and make managers worry abo earnings. The easiest way to genera growth in a slowing economy is to bu it. Kleintop notes that the average 25 premium on recent deals, vs. premiun of 40% to 60% seen in earlier M& booms, shows that near-term earnin are more of a priority for suitors th big, audacious deals made in the nan of long-term strategic goals.

The stock market is also a factor. T Standard & Poor's 500-stock index surg 3.2% in October, usually a dreadful mon for equities. Higher share prices gi companies more shopping money. T only question investors seem to be aski now is who might be bought next.

THE STAT

$99 BILLION Total global value of announced mergers and acquisitions, Nov. 1-7.

Data: Thomson Financial

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CASINO ROYALE
Sony will likely lose the James Bond franchise after 2008

MEDIA PLAYS

WHY SONY IS NOW A BIT PLAYER AT MGM

Private equity backers have taken control of the studio Howard Stringer coveted

BY RONALD GROVER

IN THE HIGH-STAKES WORLD OF private equity dealmaking, sometimes you have to be careful what you wish for. Just ask Howard Stringer. In the summer of 2004, the head of Sony of America badly wanted to beat Time Warner and win control of the faded Metro-Goldwyn-Mayer studio and its library of 4,000 films. He won the day by persuading four private equity groups, led by Texas Pacific Group and Providence Equity Partners, to chip in nearly two-thirds of the cash for a $4.9 billion deal. Six months later, Stringer was rewarded by being named the first non-Japanese to head Sony's entire parent corporation.

But in the 19 months since the deal closed, Sony has been pushed to MGM's sidelines—so much so that when MGM signed actor Tom Cruise to help run its United Artists unit, Stringer learned about it only hours before the Nov. 2 announcement. Sony's private equity partners have killed the Japanese company's lucrative deals to distribute MGM's films on video and TV. And MGM has reworked its deal with Sony to get more money from the James Bond franchise. Sony is releasing *Casino Royale,* with British actor Daniel Craig as 007, on Nov. 17, but will likely split revenues from the planned 2008 film with MGM and lose Bond altogether after that. "It was one of the most serious misalignments of a studio and investors out there," says media investment banker Stephen Prough of Salem Partners.

Almost from the beginning, Sony and its investors were on different wavelengths. A Sony-promoted deal to sell half of the rights to the UA name to former Fox studio chief Bill Mechanic for $250 million was killed earlier this yea by incoming MGM CEO Harry E. Sloan, Providence-appointed board member.

MOVING THE CLASSICS

BUT IT WAS SONY'S poor performanc selling MGM's library of old films including *West Side Story* and *Rocky*, tha most upset the investors. Sony wasn' getting anywhere near the estimated cas flow it had projected from the library, sa insiders. The DVD market had softened and Sony's own studio wasn't makin many hit movies, which are usuall packaged with older titles to help se them. "We realized that distributing th old films wasn't one of our strengths, says Sony Pictures Chairman and CE Michael Lynton. The investors, who ha inserted provisions in their deal if Son couldn't hit its targets, yanked Sony contract with three years to go, shiftin its business to Fox in return for a $62 million up-front payment.

With its 20% stake, Sony still has tw MGM board seats, but Sloan is the on running the show now. The highly r garded Hollywood executive made a kil ing selling his startup SBS Broadcastin to private equity investors and has co vinced MGM owners he can make the property more valuable as a stand-alor company. To do that, he has restarte MGM's theatrical and TV distributio arms, taking both back from Sony. Sloa intends to tap other private investors make films, including movies created Cruise. And he's intent on making mo money from the Bond franchise.

Sony executives figure they won big signing MGM to put its films on its ne generation Blu-ray high-definition DV instead of the rival HD DVD. MGM mig decide to bolt, however, especially Sloan can fix it up and sell it to someo else. Sony could outbid that compar But as Stringer recently told an indust panel about losing MGM'S DVD busine to Fox: "We screwed up." ■

The Lion Bites Back

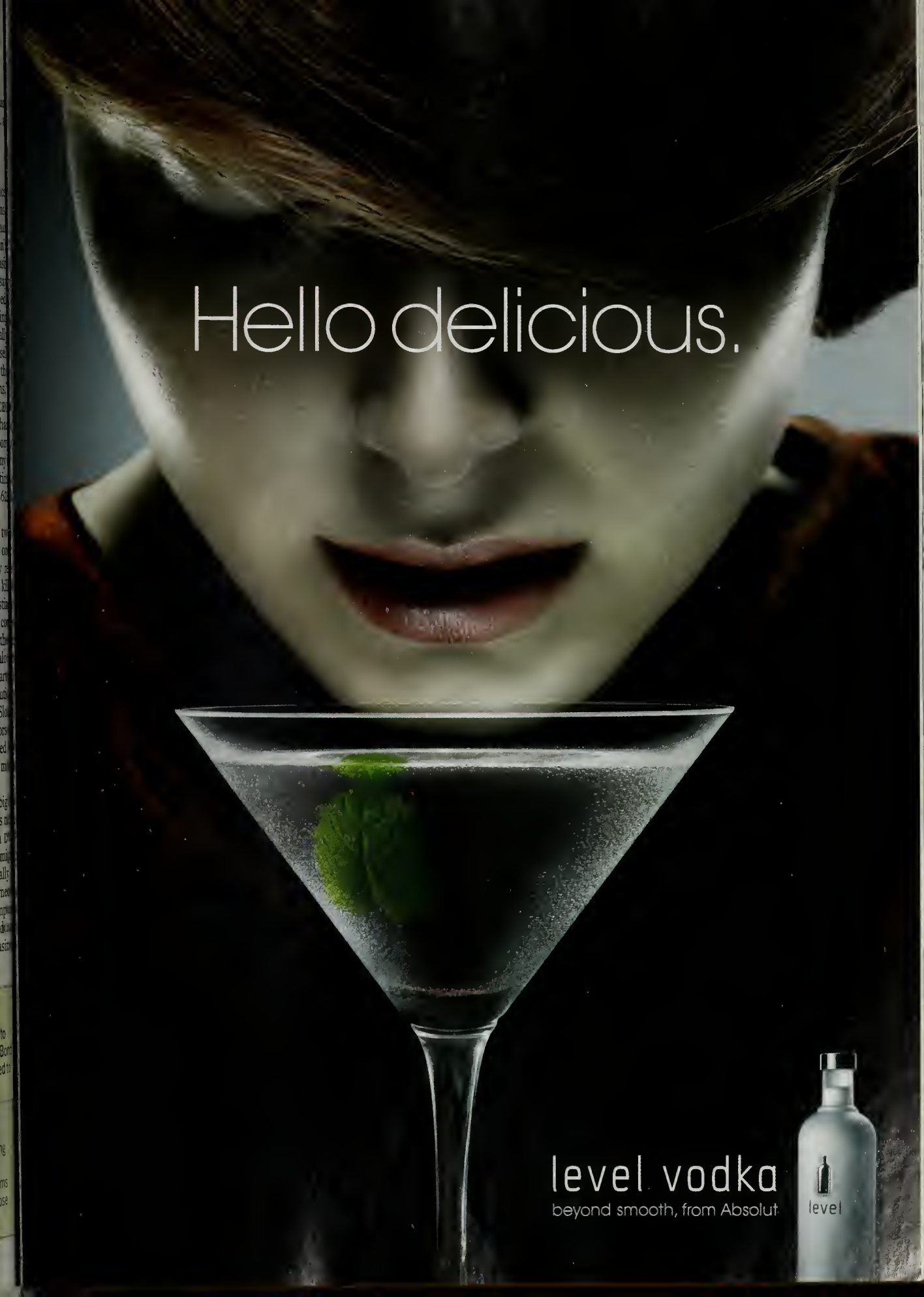
Sony thought it had become MGM's partner. Its private equity backers had other ideas:

DVD SALES
MGM cut Sony's five-year distribution deal to two years, taking Fox's $625 million offer instead.

JAMES BOND
Sony's arrangement to make the next three Bond movies was rejiggered to cover just two.

TV SALES
Despite making TV shows for MGM, Sony lost out on the right to distribute MGM's films and TV programs.

INTERNET
MGM decided to hang on to electronic distribution of its films instead of giving those rights to Sony.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VIRTUAL WORLDS

PALMISANO GETS A SECOND LIFE

BM is embracing the world of avatars—nd other big companies are, too

Y STEVE HAMM

IT'S NOT EVERY DAY THAT YOU hear the captain of a $90 billion multinational gleefully bragging about his alter ego in the online world. But these days, so-called virtual worlds are all the rage, and IBM Chief Executive Samuel Palmisano is about to make his mark the first big-league CEO to appear in virtual-world setting. "I have my own atar," boasts Palmisano. He likes the und of that so much that he says it ain: "I have my own avatar."

Actually, Palmisano has two avars—a casual Sam and a buttoned-down one—who exist in Second Life, the most popular of a handful of newfangled 3-D online virtual worlds. It's the square Sam, complete with Palmisano's signature eyeglasses and dark suit, who will be taking a virtual stage in a virtual version of China's Forbidden City on Nov. 14.

This isn't all fun and games. IBM foresees a sizable business in providing the software, computers, and chips that power 3-D worlds, and in advising clients on how to take advantage of them to market or sell products. At a real-life town hall meeting for 8,000 employees in Beijing's Great Hall of the People, Palmisano will announce just before his virtual escapade that IBM is setting up a new organization to pursue the business. It's one of a handful of initiatives he'll lay out that emerged from an online "innovation jam" the company held for worldwide employees and business partners in September. All told, Big Blue plans to spend $100 million on these projects.

BIG IDEA Palmisano's avatar will address IBMers in Second Life

WIMBLEDON IN 3-D

IBM'S FORAY IS the latest sign that the virtual world phenomenon is going mainstream. Until recently, Linden Lab's Second Life had mostly been a playground for individuals who enjoy exploring, communing with like minds, and setting up virtual mom-and-pop businesses.

In the last few months, though, all sorts of established companies have been planting their flags. They're marketing goods, trying to sprinkle coolness on their brands, and testing new kinds of online meetings. About 40 corporations have established themselves on Second Life, which has gone from zero members to 1.2 million in just three years. Among them are Sony BMG Music Entertainment, Reebok, Starwood Hotels & Resorts, and Reuters, which assigned a reporter full-time to hang out and chronicle the goings-on.

IBM stumbled into virtual reality thanks to the curiosity of British IBM software strategist Ian Hughes (avatar: ePredator Potato), who is a longtime PC gamer. Hughes started raving about virtual worlds on his internal IBM blog and, before long, IBM scientists and programmers worldwide were buying virtual islands in Second Life and using them for group collaboration or solving computer science problems.

Hughes on Nov. 7 led a guided online tour of Second Life that showed just how diverse virtual reality can be. Stops included a replica of the Wimbledon tennis club, where Hughes runs 3-D replays of actual championship games, an IBM meeting center, a Reebok store, and (whoops!) a casino complete with virtual naked female avatars. "Being the Internet, you never know what you'll find!" quips Hughes.

The most impressive locale on the tour was the scale replica of The Forbidden City being created by IBM designers, which will be the scene of Palmisano's virtual debut. The setting was unfinished, but designers had rendered a platform, chairs, and podium. The visitors' avatars wandered around and tried out the chairs, until they were unceremoniously kicked offline. The reason: IBM needed to rehearse the Palmisano appearance. Apparently, in virtual reality it's tricky for those avatars to get their applause just right. ■

INDIA

ROLLING IN RUPEES

India's surging class of millionaires is stocking up on posh pads, luxury cars, and designer duds

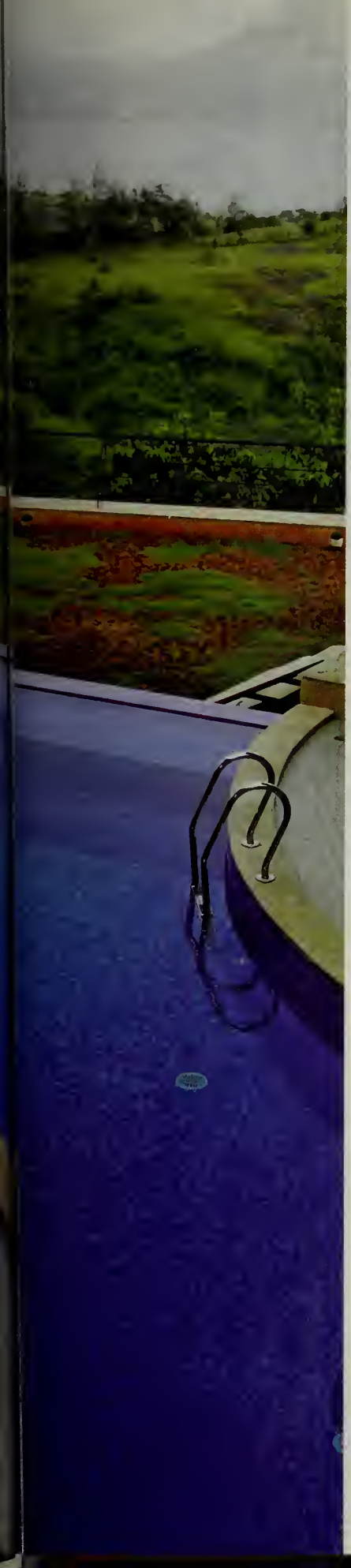
BY NANDINI LAKSHMAN

EVEN BY THE STANDARDS of Lonavala, a mountainous outpost 70 miles from Mumbai where India's nouveaux riches like to spend the weekend, Rakesh Jhunjhunwala's country home is extravagant. The 15,000-square-foot "bungalow" features a swimming pool, jacuzzi, karaoke studio, and gym, as well as party rooms and terraces where Jhunjhunwala entertains family, friends, and business associates. Meanwhile, back home in Mumbai, the chain-smoking, 47-year-old founder of investment house Rare Enterprises has just bought a $5.4 million, six-bedroom duplex apartment in the tony Malabar Hill neighborhood. "I have far more wealth than I need," says Jhunjhunwala, whose estimated net worth is just shy of $1 billion. "But it gives me the freedom to do what I enjoy and enjoy what I do."

Although hundreds of millions of Indians still live in grinding poverty, the economy is growing at an 8% annual clip, and the ranks of the well-off and just plain loaded are ballooning. Some 83,000 Indians today have liquid assets greater than $1 million, up from 71,000 two years ago, American Express Co. estimates, and their numbers are increasing by 13% a year. By AmEx' math, in 2009 there will be 1.1 million individuals with $100,000 in assets, a princely sum in India—up from 700,000 today. "I'm amazed by the wealth in this country," says Sujay Chauhan, who in April quit his job at technology researcher Gartner Group to found Aquasale, a boat dealer in Mumbai that already has seven orders for yachts worth a total of $10 million.

A lot of this is new money, not legacy Indian wealth. Up-and-coming sectors such as software services, telecommunications, finance, and real estate are minting new millionaires every day. And the Bombay Stock Exchange has more than doubled in the past two years, handing many investors tremendous capital gains. "India is the fastest-growing market for wealth creation," says Nicholas Windsor, head of personal financial services at HSBC India, which last year set up a private banking unit to cater to clients investing upwards of $500,000. Adds Ravi Trivedy, head of Business Advisory Services at consulting firm KPMG, which helps banks tailor services for rich clients: "For us it's a fabulous time."

The first place the new moneyed class typically shows off its cash is with a big house or plush apartment. While demand for homes over 3,000 square feet—palatial by Indian standards—was once confined to Mumbai and Delhi, more and more Indians in smaller cities want big houses, according to real estate consulting firm Cushman & Wakefield Inc. In September, Ambience Builders & Developers Inc.



plunked down $120 million for a 60-acre parcel in Hyderabad, with plans to turn it into high-end homes. And each of India's large cities boasts 400 to 500 houses listed at $2 million-plus, estimates Mumbai real estate agency Knight Frank. "It feels good giving your family a comfortable existence," says Rohit Roy, an actor and talk show host who last year moved into a four-bedroom apartment facing the sea in Juhu, a posh Mumbai suburb.

Cars, of course, are another great way to get mileage out of your millions. Despite duties that effectively double the price of imported autos, sales of super-luxury models are gathering speed. National Garage, a nationwide chain of dealerships selling an assortment of brands, including Ferraris, says demand for the $200,000-plus machines vastly outstrips supply. To bolster the Ferrari image, it has turned away 700 customers that "didn't suit our product profile," says marketing director Farhad Vijay Arora. Across town at Navnit Motors, customers last year snapped up 200 BMWs for as much as $150,000 and 10 Rolls-Royces topping out at $600,000-plus—about quadruple the number five years ago. "We see a sudden surge of interest in these high-end luxury cars," says Navnit's marketing director, Sharad Kachalia. To satisfy exploding demand, BMW next year plans to open an assembly plant in Chennai and hopes to expand its sales to some 1,800 Bimmers annually. That goal won't likely be hard to reach: Rival Mercedes-Benz, which already has a factory in Pune, sold more than 2,000 cars last year.

Although well-to-do Indians have traditionally been wary of flaunting their money, more are wearing their wealth on their sleeves. Louis Vuitton, Hugo Boss, Valentino, Gucci, and Fendi have all opened Indian stores in the past couple of years. And Kimaya Fashions Ltd., a high-end shop in Juhu that has long sold Indian-designed clothes to society highfliers and Bollywood stars, is stocking more global brands such as Roberto Cavalli and Giorgio Armani. "The Indian story has just begun to unfold, and now we know this is for real," says Kimaya managing director Pradeep Hirani.

WEEKEND PLACE Rare Enterprises' Jhunjhunwala is estimated to have a net worth of nearly $1 billion

There's plenty of potential growth. All told, the market for high-end luxury clothing and accessories in India is worth some $434 million a year and is apt to hit $800 million by 2010, estimates consultant Technopak Advisors Ltd. Indians last year spent $141 million on pricey wristwatches, a figure that's growing by some 40% a year, according to Technopak. "I'm not a gizmo person, but I like cars and watches," says Arun Mansukhani, 37, head of human resources at cellular carrier Hutch. His collection includes a Tag Heuer, a Mont Blanc, a Cartier—and a Porsche and a BMW. Wine sales are taking off, too, with help from the likes of the Wine Society of India. The group, established in September, held a tasting at Mumbai's stately Taj Palace Hotel, where society divas and Bollywood stars nibbled on chicken tikka and sipped $160-a-bottle Château Latour à Pomerol.

> **"India is the fastest-growing market for wealth creation"**
> *–HSBC India's Nicholas Windsor*

Not all wealthy Indians are comfortable showing off their newfound riches. Umesh Chadha runs an oil and gas services company, Luminus Energy, based in Mumbai with offices in the U.S. and three other countries. He has three cars but is also happy to get around town in a rickety three-wheeled motorcycle taxi. Although Chadha likes to vacation in the U.S.—he's planning an Alaskan cruise next year—he swears he hasn't changed much from his childhood days in Mumbai's Shivaji Park, a comfortable but not extravagant neighborhood. "I have maintained my middle-class values," he says.

Others are even more reluctant to show off. Three years ago eye surgeon Burjor Banaji bought a Mercedes C-Class sedan for his commute. He liked the Benz but sold it in September "to escape the attention, which was a nightmare." Today he drives an Octavia sedan from Volkswagen's Czech subsidiary, Skoda. "I love it," says Banaji, "because it's completely anonymous."

BusinessWeek online For a slide show on India's new millionaires, go to businessweek.com/extras.

NAMAS BHOJANI

ROLLING ALUMINUM off the line a Alcoa's plan in Hungary

CENTRAL EUROPE

MAKING GOOD MONEY OUT OF OLD PLANTS

U.S. companies are reviving Soviet-era factories—and winning new markets

BY JACK EWING

ALCOA'S MILE-LONG rolling mill south of Budapest seems like a throwback to the Soviet era. The sun struggles to penetrate smudged skylights. Massive Russian-made machines from the 1960s grind away amid clouds of steam. Forklifts the size of flatbed trucks rumble by, stacking coils of aluminum sheeting like giant rolls of toilet paper.

Yet the 65-year-old factory in the city of Szekesfehervar isn't the dinosaur it appears to be. Those brutish Russian machines, long since retrofitted with computer controls and precision rollers, need just 15 minutes to reduce an ingot the size of a sofa to a roll of sheeting a few millimeters thick. In fact, Alcoa Inc. is so pleased with its Hungarian operations that it's spending $83 million to add more modern equipment to the plant and make more sophisticated products. "The investment projects show our long-term commitment," says Bela Forgo, Alcoa's country manager for Hungary.

Across Central Europe, U.S. companies are getting great mileage out of old factories they bought on the cheap. That these soot-stained giants are worth something may come as a surprise to anyone who has spent much time in the former Warsaw Pact region. The countryside is still littered with the carcasses of factories that didn't survive the transition to market economics. But some were always more competitive than they looked.

STEAM TURBINES

LAST YEAR, ELECTRICITY producer AES Corp. converted two 1950s-era coal-fired plants in Hungary to generate power from agricultural waste such as sawdust or sunflower seed shells. While AES added equipment to burn the new fuels, Communist-era steam turbines still turn the generators. "We've managed to breathe some new life into those businesses," says John McLaren, president of Arlington (Va.)-based AES's European and African operations. And Pittsburgh-based U.S. Steel Corp. has become a major player in Europe with its purchase of a huge steel complex in Slovakia in 2000 and another in Serbia in 2003. In the secon quarter, its European operations gene ated $188 million in profits—one-third U.S. Steel's total operating income.

Central Europe's cast-offs have helpe U.S. companies conquer a piece of th Continent that might otherwise hav eluded them. General Electric Co. was a also-ran in European lighting before purchased Hungarian bulb maker Tun sram in 1989. Now GE is No.3, wi 12% of the market. And workers the have proved more adaptable than they sometimes given credit for. "Hungary an attractive place not only because asse could be bought from the governmer but also because it has a good workforce says Istvan Szini, chairman of GE's Hu gary unit. Now Hungary is home to o of GE's two main centers for lighti research and development.

Modernizing these plants hasn't be cheap, but it has turned out to be mon well spent. Alcoa has laid out $900 milli in Hungary on both acquisition costs a new gear. Today the original brick buil ings are filled with Japanese robots a German equipment. U.S. Steel last ye invested $249 million in Slovakia and S bia, with much of that used to meet Eu pean Union pollution standards. But pr its from the mill were twice that. "Prior these acquisitions we had some shipme into Europe but not many," says David Lohr, president of U.S. Steel Kosice. "T has been a major step in learning ab this market." ■

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THE GAZELLE At $8,000, it has helped GAZ grab 53% of Russia's market for small trucks and vans

RUSSIA

FROM SOVIET CLUNKER TO SPEED DEMON

New investors, foreign knowhow, and a hit van have carmaker GAZ in the fast lane

BY JASON BUSH

OVER THE YEARS, THE Gorky Automotive Plant (GAZ) has churned out everything from clones of the Ford Model A to Red Army tanks to limousines for the Communist Party elite. The factory, built in 1932 with help from Henry Ford, thrived through most of the Soviet era. But when the Soviet Union imploded in 1991, so did orders for GAZ's cars and trucks. The plant fell on hard times as production plummeted and debt ballooned.

Today, GAZ is back on its feet, with an ambitious new management team led by foreigners. At the plant in the city of Nizhny Novgorod, 280 miles east of Moscow, workers in neat blue uniforms proudly show off their Japanese-inspired production methods. Graphs and electronic displays record the performance of each work team, while photos of the disorganization of a few years ago provide a reminder of how far the factory has come. The Nizhny Novgorod operation is now the centerpiece of GAZ Group, a new automotive holding company incorporating more than a dozen factories, with earnings expected to jump 30%, to $450 million this year on sales of $4.4 billion. Already Russia's leading producer of small trucks and vans and the country's No. 2 automaker, GAZ is eyeing markets from Britain to India.

GAZ's restructuring shows how an outdated Soviet plant can be modernized to meet tough new market demands. After billionaire aluminum baron Oleg Deripaska acquired GAZ from its employees six years ago, he installed new management, spun off noncore assets such as schools and hospitals, and borrowed manufacturing techniques from Toyota Motor Corp. that have tripled assembly-line productivity. "The factory has changed fundamentally," says deputy floor manager Oleg Popov, 29. "I see a bright future."

GAZ can trace much of its success to having the right vehicle at the right time. As the economy was collapsing and few state-owned factories and farms could buy its heavy trucks, the company introduced the Gazelle van. Russia's new entrepreneurs, looking for a way to haul goods to stores and markets, loved it. Since 1994, GAZ has sold 1 million Gazelles, and sales are growing by 20% annually. The Gazelle, which goes for $8,000, helped GAZ capture 53% of Russia's market for small trucks and vans.

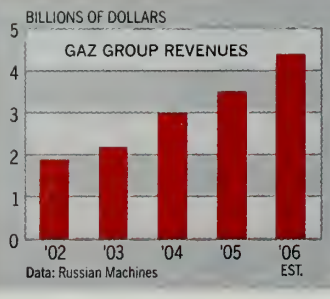
EYEING GLOBAL MARKETS

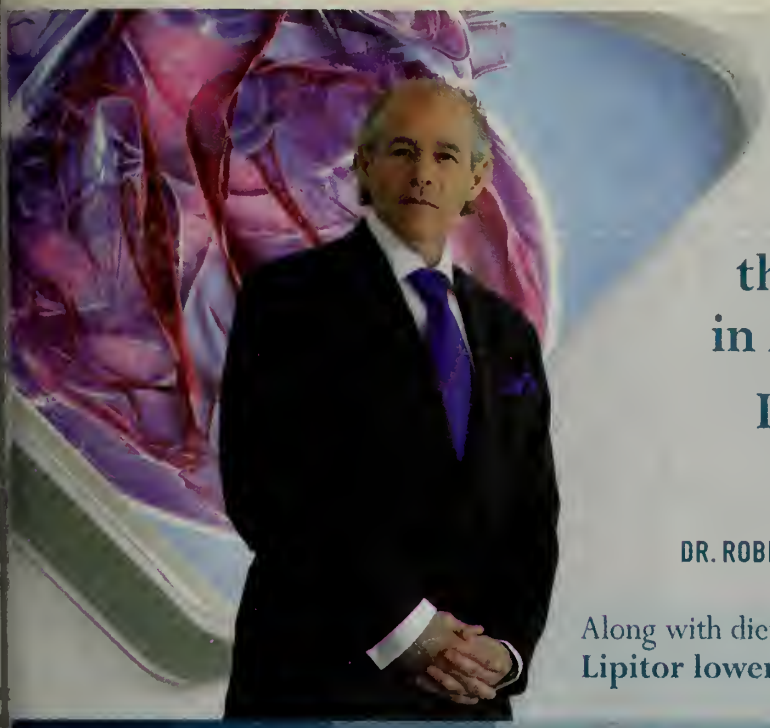
NOW THE COMPANY is looking to expand its reach. In July, GAZ made its first foreign investment, rescuing British vanmaker LDV Group from bankruptcy. GAZ's purchase came with the rights to the one-year-old Maxus van, which the Russian company plans to make both in Britain and at home. Birmingham-based LDV will also form the basis of a new entity called GAZ International—the "center for our movement outside of Russia," says Petr Zolotarev, chairman of the GAZ plant. To head it, GAZ hired Martin Leach, an industry veteran who previously ran Ford Motor Co.'s European operations. GAZ "now has access...to modern technology and a great platform for growth globally," Leach says.

Some of that technology is coming from DaimlerChrysler. GAZ last April bought a Chrysler production line in Sterling Heights, Mich., as well as a license to build a model based on the U.S. company's Sebring sedan. The plant is being dismantled and shipped to Nizhny Novgorod. GAZ will use the Sebring platform to replace the once popular Soviet-era Volga. The company also wants to boost exports from today's 25% of sales to 50% by 2013 by targeting Africa, Asia, and Latin America.

Competing globally will be tough for GAZ. The Nizhny Novgorod plant, with 50,000 workers, is still massively overstaffed. But newcomer Leach is optimistic. GAZ, he says, "is well positioned to take on some of the more established international players."

PICKING UP SPEED





"Heart disease is the #1 health problem in America. Stroke is #3. Lipitor helps reduce the risk of both."

DR. ROBERT JARVIK ~ INVENTOR OF THE JARVIK ARTIFICIAL HEART

Along with diet and exercise,
Lipitor lowers bad cholesterol 39-60%.*

*Average effect depending on dose

Unlike some cholesterol-lowering medications, Lipitor has been approved to reduce the risk of heart attack and stroke if you have several common risk factors for heart disease. Risk factors include family history, high blood pressure, age, low HDL ('good' cholesterol) or smoking.

IMPORTANT INFORMATION: LIPITOR is a prescription drug. It is used in patients with multiple risk factors for heart disease such as family history, high blood pressure, age, low HDL ('good' cholesterol) or smoking to reduce the risk of heart attack and stroke. When diet and exercise alone are not enough, LIPITOR is used along with a low-fat diet and exercise to lower cholesterol.

LIPITOR is not for everyone. It is not for those with liver problems. And it is not for women who are nursing, pregnant or may become pregnant. If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of rare but serious muscle side effects.

Tell your doctor about all of the medicines you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose. The most common side effects are gas, constipation, stomach pain and heartburn. They tend to be mild and often go away.

Please see additional important information on next page.

When diet and exercise are not enough, adding LIPITOR can help. LIPITOR is one of many cholesterol-lowering treatment options that you and your doctor can consider.

Could you be doing more...with Lipitor?

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IMPORTANT FACTS

LIPITOR atorvastatin calcium tablets (LIP-ih-tore)

LOWERING YOUR HIGH CHOLESTEROL

High cholesterol is more than just a number, it's a risk factor that should not be ignored. If your doctor said you have high cholesterol, you may be at an increased risk for heart attack. But the good news is, you can take steps to lower your cholesterol.

With the help of your doctor and a cholesterol-lowering medicine like LIPITOR, along with diet and exercise, you could be on your way to lowering your cholesterol.

Ready to start eating right and exercising more? Talk to your doctor and visit the American Heart Association at www.americanheart.org.

WHO IS LIPITOR FOR?

Who can take LIPITOR:

- People who cannot lower their cholesterol enough with diet and exercise
- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

BEFORE YOU START LIPITOR

Tell your doctor:

- About all medications you take, including prescriptions, over-the-counter medications, vitamins, and herbal supplements
- If you have muscle aches or weakness
- If you drink more than 2 alcoholic drinks a day
- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C).

LIPITOR can lower the risk of heart attack or stroke in patients who have risk factors for heart disease such as:

- age, smoking, high blood pressure, low HDL-C, heart disease in the family, *or*
- diabetes with risk factor such as eye problems, kidney problems, smoking, or high blood pressure

LP278791-F

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
- **Liver problems**. Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.

Symptoms of muscle or liver problems include:

- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
- Nausea, vomiting, or stomach pain
- Brown or dark-colored urine
- Feeling more tired than usual
- Your skin and the whites of your eyes turn yellow

If you have these symptoms, call your doctor right away.

The most common side effects of LIPITOR are:

- Headache
- Constipation
- Diarrhea, gas
- Upset stomach and stomach pain
- Rash
- Muscle and joint pain

Side effects are usually mild and may go away by themselves. Fewer than 3 people out of 100 stopped taking LIPITOR because of side effects.

HOW TO TAKE LIPITOR

Do:

- Take LIPITOR as prescribed by your doctor.
- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

- Do not change or stop your dose before talking to your doctor.
- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
- Do not break the tablet.

NEED MORE INFORMATION?

- Ask your doctor or health care provider.
- Talk to your pharmacist.
- Go to **www.lipitor.com** or call **1-888-LIPITOR**.

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CEO FORUM

THE DRAGON'S WAY OR THE TIGER'S?

A spirited debate over the merits of directed vs. democratic economies

IN BEIJING *BusinessWeek*'s Adler with the Fed's Volcker

Y BRIAN BREMNER

CHINA AND INDIA. GIVEN their sheer scale, rapid growth, and increasing political heft, they often get lumped together in discussions of the future of the global economy. t they represent radically different delopment models: India is a boisterous mocracy, while China is a single-par- command-and-control state. Which stem is better at managing a complex onomy, cultivating innovation, and dering a prosperous future?

That question triggered animated dete at *BusinessWeek*'s 10th annual CEO rum in Beijing on Nov. 1-3. The event ew more than 700 global executives as well as senior government officials from China, India, and beyond. The conference explored critical themes such as Asian corporate competitiveness, the rise of the region's marketing brands, and the disruptive impact of new digital media such as blogs and social networking Web sites. The India-China rivalry, though, remained just below the surface in almost every discussion both on the dais and in the hallways.

VOICES OF DISSENT

RONNIE C. CHAN, chairman of Hong Kong's Hang Lung Properties Ltd., riled up Indian executives by suggesting that China's system gives it an edge over India, where opponents of economic reform have a strong voice. "A democracy changes its mind all the time," Chan said. That drew an immediate retort from Ajit Gulabchand, chairman of Hindustan Construction Co. "When you look at market economies, which are the richest?" he asked. "They are democracies."

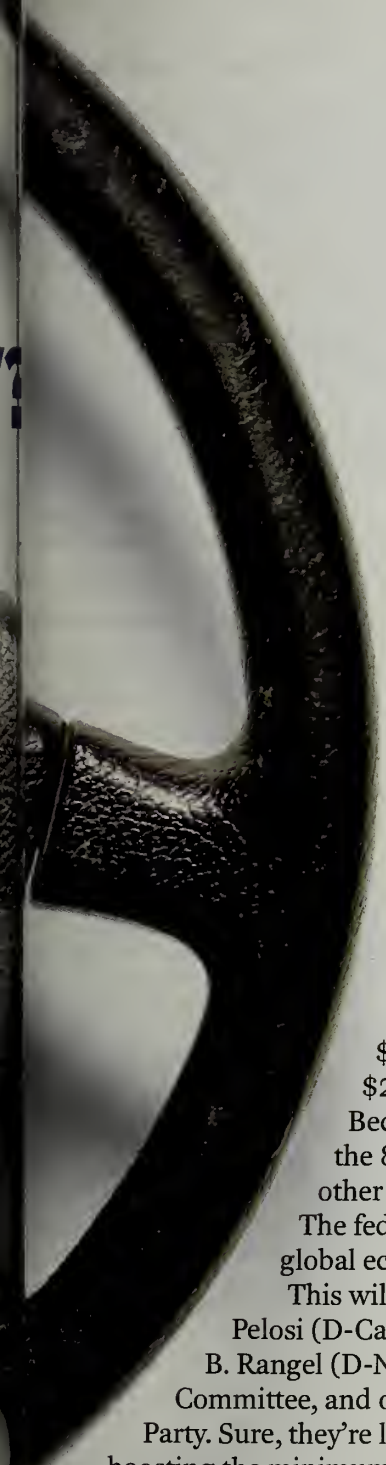
In an interview with *BusinessWeek* Editor-in-Chief Stephen J. Adler, former U.S. Federal Reserve Chairman Paul A. Volcker said China's political system and its attendant corporate and political corruption might cause trouble. "At some point, economic freedom ultimately clashes with a highly controlled political apparatus," he said. Still, Volcker conceded that the mainland's current system has managed to foster high-speed growth, and he predicted the yuan would eventually emerge as the dominant currency in Asia.

For now, both systems seem capable of producing companies that will make their mark on the world stage. China Mobile Ltd., for instance, has nearly 300 million subscribers and a $177 billion market capitalization, making it the most highly valued telecom company in the world. It has made two acquisitions in Hong Kong and aims to bag more quarry abroad, especially in the Middle East, Asia, and Latin America. "Our target is to become a world-class company," said China Mobile Chairman Wang Jianzhou. With the likes of China Mobile, telecom gear maker Huawei Technologies, and India's Tata Steel on the prowl for acquisitions overseas, China and India "are reshaping the global economy," said Yuwa Hedrick-Wong, an economic adviser with MasterCard International.

Can these two giants get along? Their rivalry is bound to intensify as India moves more into low-wage manufacturing, a Chinese specialty. Both must create 15 million new jobs every year just to keep their young people employed. China and India "are going to be competing for manufacturing jobs," said Professor Fan Gang, director of China's National Institute of Economic Research. While the economic competition may ultimately benefit both sides, he noted that "India's blue-collar wages are about half of China's." In other words, rapidly prospering China could find itself being undercut by lower-wage India. ■

"Economic freedom ultimately clashes with a highly controlled political apparatus"
–Former Federal Reserve Chairman Paul A. Volcker

CAN ANYONE STEER THIS ECONOMY?



Global forces have taken control of the economy. And government, regardless of party, will have less influence than ever

BY MICHAEL MANDEL

SOMETIME NEXT YEAR—perhaps around Christmas 2007, if current trends continue—the U.S. will hit a milestone. For the first time in recent memory, the cost of imported goods and services will exceed federal revenues. In other words, Americans will soon pay more to foreigners than they do to their national government.

We're almost there now. Imports cost us about $2.2 trillion a year; the federal government collects $2.4 trillion in revenues. Why is that important? Because for the past 70 years, Washington has been the 800-pound gorilla, more powerful by far than any other force in the U.S. economy. That's not true anymore. The federal government remains plenty influential, but the global economy is more so.

This will come as a rude shock to Representative Nancy Pelosi (D-Calif.), the presumptive Speaker of the House, Charles B. Rangel (D-N.Y.), the likely chairman of the House Ways & Means Committee, and other newly enfranchised leaders in the Democratic Party. Sure, they're likely to have the power to pass legislation, including boosting the minimum wage. But such a measure, even if President George W. Bush signed it, would help only a small fraction of the workforce. It would do almost nothing to ameliorate the weak wage growth that has plagued most mericans, including college graduates, in recent years. The broad-based drop in comes is being driven more by the rise of China and India and the intensification global competition. And there is little Democrats can do to reverse these trends.

OTOGRAPH BY KIYOSHI TOGASHI; DIGITAL IMAGING BY ROGER KENNY/BW

No matter which party you belong to, or which Big Idea or school of economic policy you subscribe to, one thing is clear: Globalization has overwhelmed Washington's ability to control the economy. Whether you're a Republican supply-side tax-cutter, a Wall Street deficit hawk of either party, or a Silicon Valley techie type, your preferred levers of economic policy just don't work as well as they once did.

As recently as 10 years ago, the U.S. economy was still relatively self-contained. Then-Federal Reserve Chairman Alan Greenspan—often called the most powerful man in the world—could be sure that the U.S. economic machine would eventually respond when he called for higher or lower rates. Tax and spending decisions made in Washington could set the course for growth, while economic events in the rest of the world, such as the Asian financial crisis of the mid-1990s, were felt as minor bumps.

That has changed. Since 1995 imports have risen from 12% of gross domestic product to about 17%. And foreign money finances about 32% of U.S. domestic investment, up from 7% in 1995. In other words, the U.S. is more open to the global economy than ever before, and the links run in both directions. Now many of the levers affecting the U.S. economy are located not in Washington but in Beijing, London, and even Mexico City.

Greenspan and his successor, Ben S. Bernanke, have found this out the hard way. To restrain economic growth and cool the housing market, the two Fed heads have raised short-term interest rates 17 times since 2004, for a total increase of more than four percentage points. But even as the Fed tightened up on the domestic money supply, foreign investors made up the difference.

As a result, the interest rate on 10-year government bonds today is 4.6%, exactly where it was in 2004, when the Fed started raising rates. Good news for home buyers who want mortgages. Not so good news for the policymakers trying for a soft landing.

> **"Traditional macro policies are less effective than they used to be. we don't know how to ensure strong job creation and strong wage growth anymore"**
>
> **–ROBERT S. SHAPIRO, ECONOMIC CONSULTANT**

★★★★★

PRESIDENT BUSH ENCOUNTERED a similar problem. His huge tax cuts poured hundreds of billions into the economy and kept output rising at a decent clip. Nevertheless, the fiscal stimulus generated far fewer jobs than anyone expected, as more and more production headed overseas. "Traditional macro policies are less effective than they used to be," says Robert S. Shapiro, a top economic adviser to President Bill Clinton who now runs a Washington economic consulting firm. "We don't know how to ensure strong job creation and strong wage growth anymore."

Pelosi and the congressional Democrats, who embraced fiscal restraint as their pre-election mantra, shouldn't expect much better economic results by pulling the deficit-cutting lever. On the campaign trail, Pelosi promised to contain the budget deficit, telling one Washington audience that "if American families are expected to balance their checkbooks, so, too, should the Congress of the United States." While that commitment may resonate politically, there's growing economic evidence that reducing the budget deficit won't do much to jazz up business investment and growth. A new study from the Federal Reserve Bank of New York, as nonpolitical an organization as you will find, reports that "investment has exhibited only a tenuous response to fiscal policy changes."

Even the Big Idea of devoting more tax dollars to research and development to make the U.S. more competitive—an idea repeatedly advocated by such tech leaders as John T. Chambers of Cisco Systems Inc. and John Doerr of venture capital giant Kleiner Perkins Caufield & Byers—is beginning to look economically and politically troublesome. True, increased funding for R&D appears to be a rare area of agreement between the two parties: Pelosi and the House Democrats came out with their "Innovation Agenda" last November, and Bush followed wit his innovation-based "Competitivenes Initiative" in the January State of the Union speech.

But in the brave new world of the global economy, where companies move factories and facilities around the world like game pieces, it's no longer a given that U.S. workers benefi directly from U.S.-funded research. One worrisome example: Despite federal outlays of over $125 billion for medical research over the past five years, the U.S. has a large and growing trade deficit in advanced biotech and medical goods. "The era in which we could assume that increased U.S. public investment in R&D automaticall generates domestic growth is over," says Jeff Faux of the liberal Economic Policy Institute.

Policymakers now face the unenviable task of managing the economy in the face of an overwhelming flow of goods and money back and forth across national borders. "The federal government affects the economy only on the margins," says Charles R. Black Jr., Republican consultant and outside adviser to President Bush. Adds Timothy J. Penny, a former Democratic representative from Minnesota who is now at the University of Minnesota: "Washington is far less relevant than it used to be. You don't have to be an economic professional to see the evidence."

And get this: We don't even know how to measure whether we as a country are succeeding or failing. The traditional metrics for economic security and prosperity are capturing impressive signs of life. Unemployment, inflation, and interes rates are low by historical standards. The stock market is rising, and household wealth is higher than it was at the peak of the 1990s boom, even after adjusting for inflation. To a larg extent, this is thanks to the global economy, which has been fueling the U.S. expansion with cheap goods and cheap mone Yet real wages are down over the past five years, the trade deficit is enormous, and there are widespread worries about America's continued ability to compete.

THE FOUR BIG IDEAS OF ECONOMIC POLICY

Policy Classic

ALIAS: Keynesian economics.

MAIN PROPONENTS: Almost everyone.

HOW IT WORKS: Increase government spending, cut taxes, and slice interest rates to fight recessions.

WHY GLOBALIZATION AFFECTS IT: Fiscal and monetary stimulus now increases the current account deficit rather than creating jobs at home. Interest rate cuts will have little effect against an economic crisis caused by a falling dollar.

Supply Side

ALIAS: Dynamic scoring.

MAIN PROPONENTS: Ronald Reagan, George W. Bush.

HOW IT WORKS: Cut tax rates to boost work effort, savings, and entrepreneurial energy.

WHY GLOBALIZATION AFFECTS IT: Tax rates are just one out of many factors that matter for global competition. There's only weak evidence that tax cuts really have a big impact on growth.

Deficit Cutting

ALIAS: Rubinomics.

MAIN PROPONENTS: Mainstream Democrats and Republicans.

HOW IT WORKS: Shrink the budget deficit to promote savings and investment.

WHY GLOBALIZATION AFFECTS IT: In a global economy, the U.S. budget deficit has little effect on interest rates or on the trade deficit. A focus on fiscal restraint also holds back essential investments.

Innovation Policy

ALIAS: New Growth Theory.

MAIN PROPONENTS: Technology heavyweights such as John Chambers and John Doerr.

HOW IT WORKS: Boost government spending on education and research and development in order to stoke growth and competitiveness, and improve living standards.

WHY GLOBALIZATION AFFECTS IT: Global competition is helping push down real wages for young Americans with bachelor's degrees. R&D is moving to India and China.

Washington has responded to these concerns, in large part, with a series of small fixes, like tinkering with the pension system. But what's needed is a new Big Idea for economic policy—or two or three competing Big Ideas—that accounts for the verities of the global economy.

The first step is to get a better handle on what's really happening to U.S. workers and businesses in today's economy, where wealth is as important as income, and where events in Shanghai are as important as events in Chicago. If the value of a family's home goes way up, but its income dips a bit, is the family better or worse off? If a U.S.-based company opens up an R&D facility in India or China, does its employment of American workers go up or down—and, does its overall contribution to U.S. growth increase or decrease? We don't have the statistics needed to answer these questions.

Second, we need to take hold of the main unused lever of economic policy: health care. Politicians and economists have mainly thought of health care as a cost that is dragging down competitiveness. Health-care spending is the main source of long-term federal, state, and local budget deficits, the prime gobbler of national savings, and one of the biggest tax distortions, in the form of the tax exemption for company-provided health insurance.

All these things are true. But health care is also a huge source of private sector jobs, one of the most technologically advanced sectors of the economy, and frankly, the provider of a service people can't get enough of. It can even be thought of as an investment, to the degree that better health allows Americans to work longer and to better enjoy their lives. We have to view health care as a force for growth, rather than an impediment.

Finally, a Big Big Idea—probably too big to even consider right now—would be the creation of global institutions for governing the world economy. History tells us that market economies are prone to financial crises, to which the only solution is a strong central bank. During the Asian financial crisis of the 1990s, for example, the Fed played that role.

But with the explosive growth of China and India, that sort of role for the Fed is no longer feasible, and no new institution has arisen to take its place. As former Treasury Secretary Robert E. Rubin, now a top official at Citigroup, recently said: "There's no policy mechanism for bringing together the countries that really matter in the global economy." The best solution would be some sort of global central bank with real powers—but that's not going to happen until there's a big enough financial crisis to truly scare people.

RANGEL Clout in Congress, but a limited ability to affect the economy

★★★★★

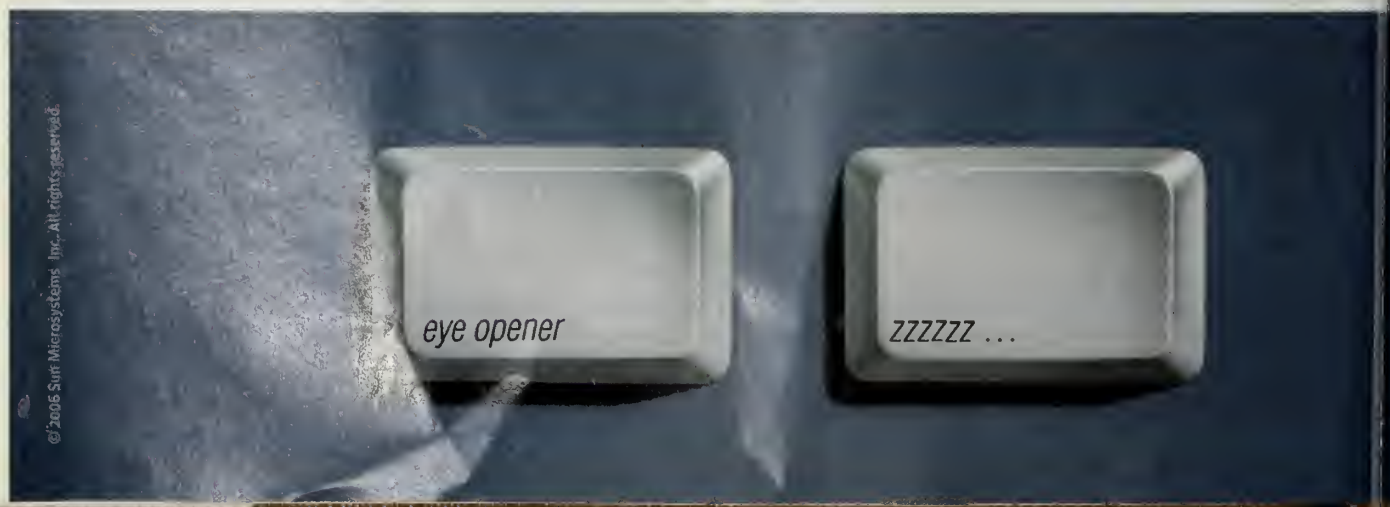
ECONOMIC POLICY, IN THE SENSE that we understand it today, is a comparatively recent invention. It started with John Maynard Keynes in the 1930s. He put forth the Big Idea that governments had the ability to soften a downturn. Keynesian economics, as it was termed, calls for reducing interest rates, cutting taxes, and hiking government spending to ease the worst effects of recession.

Today, Keynes's prescriptions could be called Policy Classic, since even diehard free marketeers agree that fighting recessions is the right thing for governments to do. What's more, Policy Classic still works in the modern global economy, up to a point. When a fire starts in your house, you should still try as hard as you can to douse it with water, even if your hose is leaky.

Consider how Washington responded to the recession of 2001. One could quibble with the exact timing of Greenspan's rate cuts, and the Democrats weren't particularly happy with the Bush tax cuts. But there's no disputing that massive amounts of fiscal and monetary stimulus made the 2001 downturn one of the mildest on record. And the recovery hasn't been half bad, either. Since the economy peaked in the second quarter of 2001, economic growth has averaged a decent 2.8%.

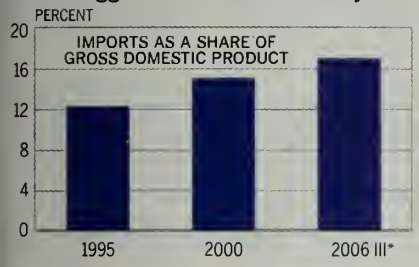
Yet the recovery could have been a lot stronger, given the amount of stimulus pumped into the economy. Consumers and businesses aren't fools: They used their extra money to buy cheap imports rather than more expensive American-made goods and services. Between 2001 and today, imports rose by three percentage points as a share of GDP, one of the main reasons that job growth was so slow. By comparison, the import share rose by only one percentage point or so in the recoveries of the early 1980s and the early 1990s.

In an open economy, Policy Classic loses its punch. The inability to create jobs after a recession is bad enough. What



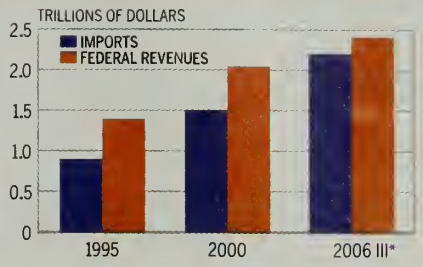
WHY THE ECONOMY IS SO HARD TO CONTROL

Spending on imports is a bigger share of the economy...



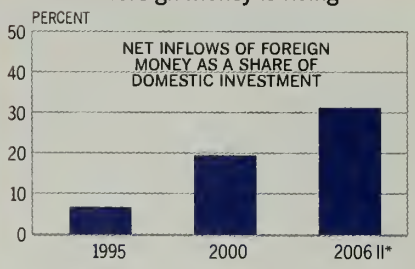
Data: Bureau of Economic Analysis

...and catching up to federal revenues...



Data: Bureau of Economic Analysis, Treasury Dept.

...while U.S. dependence on foreign money is rising



Data: Federal Reserve

*FOUR-QUARTER AVERAGE

ally should concern us all, though, is what might happen in e next recession. Foreign investors have been extraordinarily illing to put their money into the U.S. But let's suppose, just r the sake of argument, that a recession here makes other untries look like a better bet. Then foreign investors pull out eir money, pushing interest rates way up and the dollar way own. The higher rates slow the economy, and the lower dollar akes imports more expensive, triggering higher inflation.

Poof! Instant stagflation. And what's worse, Bernanke d the Fed will be forced to keep interest rates high to ght inflation.

But enough of cataclysmic scenarios that might or ight not happen. The question to ask is this: How does obalization affect the long-term policies for growth, both eral and conservative, rolled out by the U.S. in recent cades? Probably the best known is supply-side economics, hich originated in the 1970s and achieved prominence der President Ronald Reagan in the 1980s. Like all Big eas, the logic behind supply-side economics is clear: Lower x rates give workers an incentive to put in more hours, courage savings and investment by increasing the aftertax te of return, and spur entrepreneurs to expand their sinesses by allowing them to keep more of the profits.

According to Kevin A. Hassett, director of economic licy studies at the American Enterprise Institute, obalization actually increases the pressure to cut taxes. tax rates are too high, "corporate income is so mobile at the money just leaves," says Hassett. "There's an ternational tax competition, and everyone is playing."

Yet economists are hard-pressed to find evidence that tax cuts have a big effect on growth. Last summer, the Treasury Dept. released a study that looked at the long-term impact of extending President Bush's tax cuts, which are due to expire at the end of 2010. The study concluded that extending the tax cuts indefinitely would boost GDP by only 0.7% over the long run. That's less than a rounding error.

It's also clear that having a low tax rate is only one factor among many determining international competitiveness. It's equally important to have an honest government, or an efficient health-care system, or an educated workforce. "There isn't a single blueprint for a successful economy," says Robert E. Hall, a Stanford University economist who was one of the main advocates of a flat tax in the 1980s.

On to the next Big Idea: deficit reduction, a mirror image of supply-side economics that the Democrats have made the centerpiece of their political and economic agenda. "Fiscal responsibility is important for the long term," says Bruce Reed, president of the Democratic Leadership Council. "The overall economy is going to pay a price if the country is going broke."

The case for deficit reduction as a long-term growth strategy is also straightforward. Smaller budget deficits are supposed to boost national savings, which leads to lower interest rates, smaller trade deficits, increased investment by businesses, and more job creation. And certainly that's the way it worked in the 1990s, when Rubin was running economic policy under President Clinton—hence the name Rubinomics.

But this line of reasoning doesn't hold up so well in an economy that is far more exposed to global forces than it was in 1993, when Clinton took office. The financial markets have become far more seamlessly global, making

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the U.S. budget deficit a much smaller influence on interest rates. Today's roughly $250 billion deficit would use up about 14% of U.S. national savings. That's a big deal, but it's only 2% of global savings.

The ease with which capital flows across national borders helps justify the Bush Administration's relative lack of concern about budget deficits or even personal savings. "What starts to break down is the simple link between encouraging savings and encouraging investment," says James S. Poterba, a Massachusetts Institute of Technology economist appointed by Bush to his tax reform commission in 2005. "If Joe in Pittsburgh saves, we can't say that we benefit this factory in Harrisburg. The jobs we generate might be jobs somewhere else"—like overseas.

So if globalization weakens the usefulness of tax cuts and deficit reduction as policy tools, what's left? The New Economy boom of the 1990s was driven by technological change and innovation. The logical way to rekindle the magic, then, is to boost government spending for R&D and education. Just listen to Daron Acemoglu of MIT, the most recent winner of the John Bates Clark Medal, given to the best economist under the age of 40. "The U.S. is a frontier country," says Acemoglu, meaning that its competitive advantage comes from being at the forefront of new technology. As a result, he says "if any policy is going to have a beneficial effect, it has to help the innovation sector."

This Big Idea was first suggested by Paul Romer, now at Stanford University, in the 1980s, and named New Growth Theory. That term fell out of favor after the tech crash—perhaps because it sounded too much like the New Economy—and the Big Idea now goes by the prosaic name "innovation policy."

The problem is that it's tough to make a direct connection between federal R&D spending and the creation of high-tech jobs. Despite the U.S. prominence in medical research, the pharmaceutical, biotech, and medical devices industries have added only 19,000 workers in the past five years.

★★★★★

THE TRUTH IS, CHINA and India are increasingly attractive places for companies to do research and development (using ideas, perhaps, that were originally developed using U.S. tax dollars). Money is following as well, with U.S. venture capitalists investing more than $400 million in Chinese and Indian companies in the third quarter alone, according to the National Venture Capital Assn. There's a growing sense that at a time of scarce resources, the U.S. may not be getting enough bang for its buck from R&D spending. "The question about funding basic R&D for health care is the same as for funding other basic R&D," says Robert B. Reich, Labor Secretary under Clinton and now at the University of California at Berkeley. "How long can and should the U.S. continue to subsidize the rest of the world?"

This question becomes especially pressing if the newly resurgent Democrats carry through on their promise to put in place a "pay-as-you-go" budget system whereby new spending cannot be financed by increased borrowing. Who is going to vote an increase for science if it means raising taxes or cutting spending for children? The last bout of meaningful deficit reduction, during Clinton's first term, did serious damage to R&D spending, which dropped by 3.9% in real terms.

Education poses a different set of issues. Clearly, education is key to competitiveness. "If an educated population is the engine of change, then we're doing a really, really lousy job," says Claudia Goldin, a Harvard economist who is co-authoring a book about education and technology. "We have been un-subsidizing higher education for some time."

> **"If an educated population is the engine of change, then we're doing a really, really lousy job. We have been un-subsidizing higher education for some time"**
>
> **–CLAUDIA GOLDIN, HARVARD UNIVERSITY**

There are two problems. First, real wages for young Americans with a bachelor's degree have declined by almost 8% over the past three years. Nobody knows the reason for sure, but some economists suspect that global competition has something to do with it.

The other problem is that education is closely tied, in tricky ways, to the hot-button issue of immigration. Despite post-September 11 restrictions, foreign students with temporary visas still account for almost 40% of new graduate students in science and engineering. We still need to spend more on education, but in an era of labor mobility the decision about where to put our resources is not a slam-dunk.

With the Big Ideas under assault by globalization, economists have responded by focusing on smaller goals. "Are there places where we can make sensible improvements that don't require big philosophical changes in what we are doing?" asks Poterba of MIT. For example, the new pension bill encourages companies to automatically enroll new hires in 401(k) plans unless they opt out. Economists believe that will greatly increase savings by workers. Not as big a deal, perhaps, as full-scale tax reform, but a gain.

Beyond that, the idea of a national economic policy may be fundamentally out of date in a world of global markets. Washington is no longer the center of the economic universe. That's a basic fact that Democrats and Republicans alike will need to get their heads around. ■

–With Richard S. Dunham in Washington

All Eyes on the Economy

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Generally Improvable Accounting Principles

FASB may be ready to give investors more influence on GAAP—and executives less

BY DAVID HENRY

IN THE AGE-OLD QUEST TO FIGure out how much companies are really worth, investors are usually at a costly disadvantage to the executives who craft corporate financial statements. But now the Financial Accounting Standards Board, the seven-member body charged with writing Generally Accepted Accounting Principles (GAAP) and setting the rules on how companies can count their profit, cash flow, and net worth, is trying to make the game more fair.

Over the years FASB has taken a lot of criticism for allowing executives too much leeway to exaggerate their results. Now some key members are acknowledging what critics have said all along: The board is influenced too much by corporations and auditors and not enough by investors. They say that once a week, on average, executives from various industry trade associations arrive at FASB's Norwalk (Conn.) headquarters to press for changes to GAAP that suit their own particular needs. For example, a committee from Financial Executives International (FEI), a major group of corporate financial officers and controllers, meets with the board every quarter. "And we hear from the auditing firms every day," says FASB Chairman Robert H. Herz. By contrast, investors infrequently make their opinions known. "We have a hard time hearing from [them]," says Donald M. Young, another board member.

Now Young, with the encouragement of Herz, is reaching out. He's enlisting the best financial statement analysts and the biggest institutional investors to tell the board how GAAP should be changed. He's revamping an eclectic User Advisory Council, building up a trust of on-call experts at the largest fund management companies, and assembling a committee of investor-friendly CPAs, including the outspoken Lynn E. Turner, a former chief accountant at the Securities & Exchange Commission, and Jack Ciesielski, publisher of *The Analyst's Accounting Observer* and a sharp critic of the many numbers games executives play. "We've decided to go out and grab [investors] by the neck and drag them into the process," says Young.

One reason for FASB's new approach might be a change in its funding sources. Critics have long contended that FASB's corporation-friendly attitude stemmed from the fact that its funding came mostly from auditors whose interests were aligned with their clients. The Sarbanes-Oxley Act of 2002 changed that; now FASB is funded primarily by standard fees assessed o public companies.

Whether or not there was a conflict interest, there's a long list of examples excessive executive influence on FAS notes Paul B.W. Miller, a professor of a counting at the University of Colorado Colorado Springs. The pension accoun ing standard that severely distorted th earnings and balance sheets of larg industrial corporations in the late 199 was the legacy of strong business lobb ing in the mid-1980s. Lease accountin which keeps many obligations off ba ance sheets, has a similar history. An today's stock options mess was fed b executives' successful drive to portra options as free money by keeping the cost from being counted as a compens tion expense.

PANEL REDESIGN?

YOUNG SAYS THE TIME has come, to to change the traditional mix of FAS members. Three of the seven are form auditors, and two are former executive "That's a majority right out of the bo of people who made careers preparin and auditing financials, he says. Youn a former stock analyst, and a profe sor of accounting fill out the panel. O vacancy, a seat held by a former audit is coming up next year and should filled by an investor, Young says. He a former auditor, but one who manag investments for 2,000 partners, sto short of recommen ing such a chang saying good boa members consider perspectives. Young idea has yet to ga any serious tracti among the 16 truste of the foundation th appoints the board a itself is monitored the Securities & E change Commissio SEC officials decli to comment.

> Funding changes could make boards less friendly to corporate interests

But Young may eventually g his way. A spokeswoman for t American Institute of Certifi Public Accountants, which rep sents auditors, says the truste should consider appointing investor to the next vacancy aft this one. And even the preside of FEI says she would supp having an investor replace auditor on the board. Chan may come slowly at FASB, but is possible. ■

Some think breakfast.

We think research.

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In Mexico, Banco Wal-Mart

It may soon get a bank license there, and that could have a huge impact on financial services

BY GERI SMITH

FOR YEARS, WAL-MART HAS tried to get into banking in the U.S. But so far it has come up empty-handed as everyone from rival banks to unions rose up in opposition. South of the border, though, the world's biggest retailer may soon receive a banking license, paving the way for Wal-Mart Stores Inc. to offer checking and savings accounts, loans, credit cards, and more across its network of 863 outlets in 130 Mexican cities.

Why is Mexico willing to give the green light while the U.S. drags its feet? From Central Bank Governor Guillermo Ortiz on down, Mexican officials want to boost competition in financial services and cut the sky-high fees and interest rates charged by Mexico's big banks. They also want to spread banking services to the 80% of Mexicans who have never had a bank account. Allowing Wal-Mart and several smaller r tailers to compete i banking "will mal a difference in ec nomic well-being ar growth," Ortiz says.

Mexican banking ripe for change. Ov the past year, consum credit has jumped b 43%, and mortgag lending is up 80% thanks largely to a d cade of economic stabi ity. Big banks, thoug continue to charge in terest rates well abov those in the U.S. Mor gages run about eigh percentage points high er than Mexican Tre sury bills, while the spread in the U. runs one to two points over the U. Treasury 10-year note. Interest on credi card balances is typically 35% in Mexic far more than in the U.S. "The market growing so fast that [banks] haven't ha to compete on price," Ortiz says. "Wh they're really doing is prolonging the extraordinary profits."

The Age

Selling made easy
3500 BC

Pictures made easy
1888

Toast made easy
1919

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It's unclear how quickly Wal-Mart's entry might eat into those profits. The retailer says it is preparing to offer savings accounts and consumer loans at in-store branches first, with mortgages and car loans likely to follow. Locals are hoping for rapid change. "It's good that Wal-Mart is going into banking," says Estela Villalobos, a Mexico City homemaker who shops at a Wal-Mart Supercenter in her middle-class neighborhood.

UNDER THE MATTRESS

EVEN IF WAL-MART doesn't immediately shake up the competition, it could provide new choices for the 12 million Mexicans who work off the books in trades such as plumbing, construction, and housekeeping. Because the big banks require hefty minimum balances, these laborers can't get credit, and they tend to keep their money under the mattress. To date, only Banco Azteca, created four years ago by an appliance chain, has targeted that market. Banco Azteca now boasts $3 billion in assets, 7 million credit customers, and 8 million savings accounts, which require only a $5 minimum balance.

Big banks are worried. "It's clear that they're going to give the license to Wal-Mart, but we want them to operate under the same rules we have to," says Jorge Hierro, executive director of institutional relations at Citigroup-owned Banamex. Banks fear that Wal-Mart may try to collect deposits and loan payments at cash registers, which would give the retailer tens of thousands of "teller windows" with little security expense. Traditional banks must provide bulletproof glass and video surveillance at teller windows.

The potential for widespread consumer opposition to any Wal-Mart banking license seems remote. On Nov. 14 the National Front Against Wal-Mart, a Mexican organization, and a San Francisco-based human-rights group called Global Exchange plan to gather outside Wal-Mart de México's shareholder meeting in Mexico City. "The Mexican authorities should say no to the banking license," says Rubén García of Global Exchange, which faults Wal-Mart for allowing teenagers to bag groceries just for tips. Chances are, the protesters will be ignored by the shoppers thronging the adjacent Wal-Mart Supercenter. The company earned $891 million on $15.5 billion in sales last year and is Mexico's largest private employer, with 141,000 employees. The government, meanwhile, credits the "Wal-Mart effect" for part of its success in slashing inflation from nearly 19% to 4% since the American company entered the country 15 years ago, so the retail giant hasn't been as dogged by controversy as it has in the U.S. "Many Mexicans are glad to see Wal-Mart coming in to break up our banking oligopoly," says Marco Antonio Cerón, president of the Mexican Institute of Financial Executives. "We need the competition."

What's Going On Across the Rio Grande

- Consumer credit is growing at a 43% annual clip
- Mortgage lending is up 80% this year
- Just 20% of Mexicans have a bank account
- Government hopes competition will push down fees

Data: Banco de México

IF YOU COMPLETELY CHANGED THE WAY YOU VIEW YOUR COMPANY, WHAT WOULD YOU SEE?

What if you didn't see your company as a stock symbol or a building made from concrete and steel? Today, many corporations are seeing themselves as a living, breathing organism. Because instead of seeing hundreds or thousands of individual employees who work for their company, they're seeing a total population who literally *are their company.*

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Applying advanced analytics and research methodologies, terabytes and terabytes of data are analyzed to determine what is effective in managing at-risk behaviors and progression of disease. This research, conducted by the Center for Health Research, is the cornerstone and proof source used to improve programs that offer millions of people healthier, more productive lives today.

When companies have such objective data at their fingertips, they are able to make meaningful, informed decisions on what additional support to provide, based on the specific needs of their workforce.

Though the data is complex, the bottom line is simple. From the chronically ill to the fittest of the fit, Healthways offers the programs to foster a healthier, more productive workforce. And when you equate that workforce's health to the health of the company, the possibilities are endless.

Healthways and the Center for Health Research are reshaping the future of health and care support. The data and the unique team of analytical experts needed to make a difference are hard at work. We invite you to help us rethink healthcare.

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This excerpt from a recently published research study is a powerful example:

To understand the significance of the myhealthIQ℠ program, you must first appreciate the scope of the problem it is overcoming. Employers picked up the tab for 86 percent of the $1.6 trillion spent in 2002 for private healthcare in the United States[1] while the cost of treating obese patients soared to almost $37 billion in 2002 from $4 billion in 1987.[2]

Despite many companies proactively addressing these problems through wellness programs, the problems continue. A random sample of 12,000 participants who completed the myhealthIQ Health Risk Assessment and Worksite Medical Exam revealed that most people are grossly unaware of their current state of health. For example, 74 percent did not know their own levels of cholesterol, blood pressure or body fat. And some 42 percent more participants tested positive for nicotine than reported that they smoked.

Why myhealthIQ is the only real solution to these problems.

The myhealthIQ program is the only corporate health risk management program that rewards employees based on objective, quantifiable and improved biometric values. The worksite exam checks 11 lifestyle biomarkers, including nicotine levels, blood pressure, body fat and total cholesterol levels. The questionnaire deals with issues such as emotional health and work/life balance. Once assessed, each employee receives a myhealthIQ score between 0 and 100. When companies have such objective data at their fingertips, they are able to make meaningful, informed decisions on what additional support to provide, based on the specific needs of their workforce.

myhealthIQ is successful because it detects at-risk populations before they become chronic and costly. And by rewarding those who are healthy, it prompts early treatment for those with undetected risk factors, and improves adherence for those with chronic illness. With over 80% of employees participating year-to-year on average, companies are literally getting healthier, and, of course, so are their bottom lines.

1 ("Health Spending Rebound Continues in 2002," *Health Affairs*, January-February 2004)

2 (*Health Affairs*)

Visit www.healthways.com/research for a full copy of this myhealthIQ report, as well as many others.

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Getting Marsh Out of the Swamp

Mike Cherkasky's next task is unifying the giant's ill-fitting divisions

BY JOSEPH WEBER

MICHAEL G. CHERkasky, the scrappy prosecutor-turned-corporate chief at Marsh & McLennan Cos. (MMC), is savoring a moment of sweet vindication. For much of the past two years he has been slammed as an insurance industry naïf and a novice chief executive out of his depth at the troubled $12 billion-a-year company. He has been pressed to sell MMC to buyout firm Kohlberg Kravis Roberts & Co. He was even ridiculed by CNBC's Jim Cramer, who put him in *Mad Money*'s "hall of shame" in August after a disappointing quarter, arguing that Cherkasky's departure would drive up MMC's stock 25%, to 32.

So the healthy quarterly gains Cherkasky announced on Nov. 1, showing that net income more than doubled, at last gave him something to brag about. "The initiatives we have talked about over the last year are working," crows Cherkasky. Recently MMC's share price topped 31, right about where Cramer said it would be if the CEO stepped down.

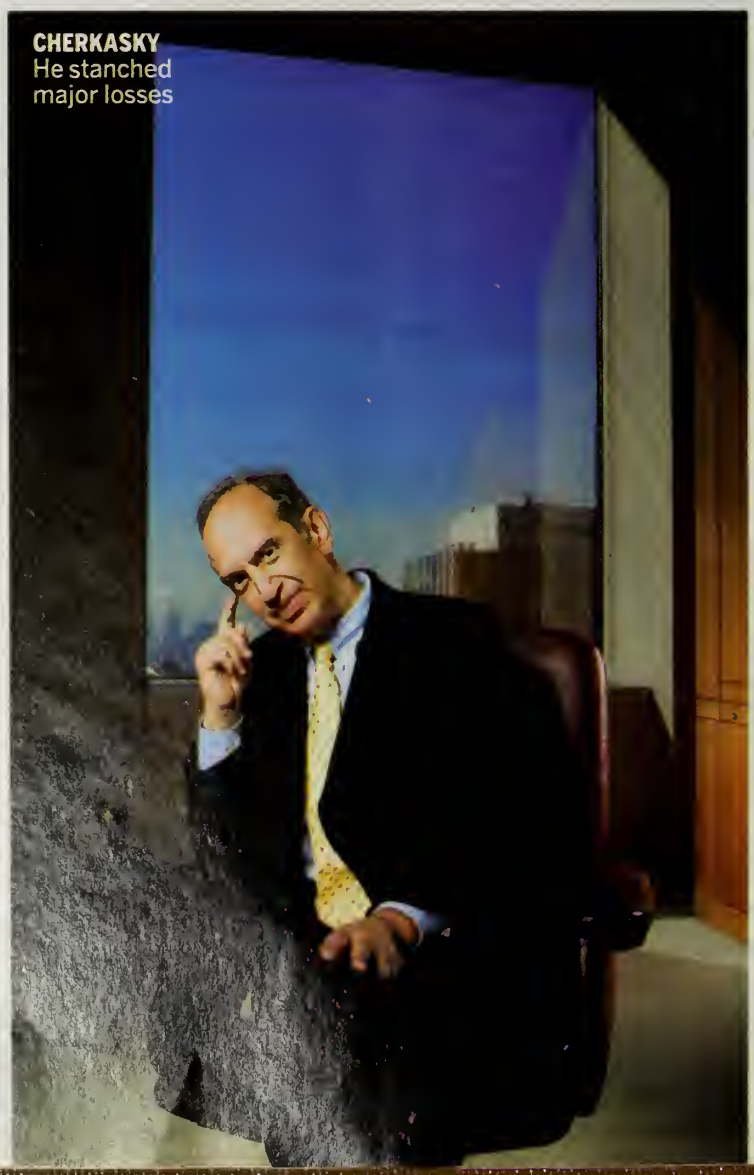
But Cherkasky shouldn't gloat. There has never been a doubt that the accomplished lawyer, who prosecuted murderers and investigated terrorists for the Manhattan District Attorney's office, rescued MMC from certain ruin last year at the hands of New York Attorney General Eliot Spitzer, a longtime pal. He staved off an indictment for bid-rigging by reaching an $850 million settlement with Spitzer and making tough efforts to clean house. Cherkasky must now, however, breathe life into the hodgepodge of companies that form MMC, developing synergies among the corporate insurance brokers at Marsh, the human resource consultants at Mercer, and the corporate sleuths at Kroll.

He insists the outfits are better together, even though their only apparent common denominator is that they serve man of the same companies. Forging the link "is something that has taken longer than anyone expected, he concedes.

Cherkasky's few years in the corne office, first at Kroll and then at the muc larger MMC, have amounted to a bruis ing education. Life as a CEO, he says, i far different from anything he has don before. As a lawyer, corporate monitor, c a consultant—all of which he has been, a various times—"you give advice and yo go home," he says. "As th person who actually has t do it, you stay up at nigh worrying about whethe you've gotten it right."

When Cherkasky go the top job in late 2004 he had been at the com pany just a few month having come aboar when MMC acquire Kroll in the middle c that year. Investors a first hailed him as a sav ior but then soured o him as results sank ove several quarters. MMC' stock fell from nearly 5 a share in 2003 to a lo of 24 last August.

Cherkasky, 56, blame much of the slide on th difficulty of righting ship whose 55,000 en ployees worldwide a clinging to old ways c doing business. He con pares his efforts to f MMC with his work as court-appointed monit for the Los Angeles Poli Dept., which he has ove seen since 2000, whe the federal governme found that the LAPD ro tinely violated citizen constitutional rights. A both MMC and the LAP he says, huge numbe of 20- and 30-year staf



CHERKASKY
He stanched major losses

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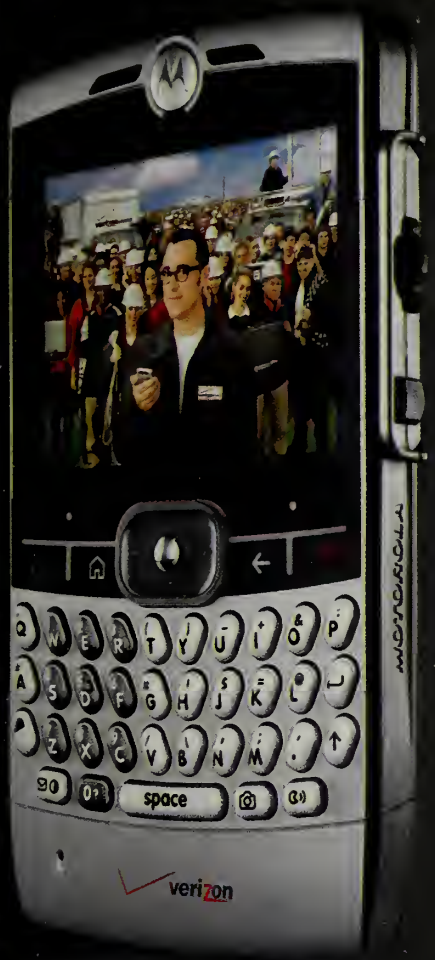

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ers simply "hold their breath for five years," hoping to outlast change-minded bosses instead of changing their ways.

But some of the moves Cherkasky engineered are paying off, especially in the past quarter. Fewer clients and staffers are defecting to rivals. For instance, Cedar Fair Entertainment Co., a $1 billion Sandusky (Ohio) theme-park owner, quit Marsh in early 2005 as an insurance brokerage client to try rival Aon. But last spring it returned. Cedar Fair Chief Financial Officer Peter J. Crage mostly credits Marsh's expertise in insuring park, hotel, and marina properties, but says a phone call Cherkasky made to Cedar Fair in early 2005 didn't hurt. "He was setting the right tone and moving in the right direction. That was reassuring to us," Crage says.

Cost-cutting has also helped MMC. Cherkasky trimmed some 5,750 jobs in three rounds of restructuring, boosting efficiencies. Such cuts, he says, were needed to make MMC as nimble as the upstarts that are giving it fits. And yet he knows keeping morale up is daunting, especially when Wall Street shows far less patience than even the crustiest of judges. "If you see some more bleeding of employees and morale doesn't significantly improve, you're never going to see the revenues come back," warns UBS Securities analyst Brian R. Meredith.

Notwithstanding the shakeup, Cherkasky complains that MMC staffers still resist efforts to cooperate with employees from other divisions. That has set back his moves to boost revenues by cross-selling services. He talks up examples of synergies, such as a global media client that uses Marsh to manage its insurance needs and recently tapped Mercer for advice on health coverage. "I don't want there to be divisions in Marsh or divisions between Marsh and Mercer," he says. But he frets that the culture change needed for staffers to see value in such strategies can't happen "in a week or a month or a year."

SALES-MINDED

WHILE MIDWIFING the slow culture shift, Cherkasky must generate results fast to please shareholders. They'll have reason to cheer if he sells or spins off the Putnam mutual fund operation, tarnished by th trading-abuse allegations of 2003 involv ing market timing. Although mum on h exact plans for Putnam, he is weighin offers from prospective buyers even whi tax reasons may make a spin-off to share holders more appealing. The outfit doesn fit with the other MMC units, he says, bu he figures he'll get top dollar only whe

BIO

Michael G. Cherkas

CAREER Worked for 16 years in criminal justice as a tr attorney, administrator, and investigator before enteri corporate world via Kroll Inc. in 1994. Became CEO of & McLennan in 2004.

LEGAL HIGHLIG Convicting two c sellers for murde a taxi driver—aft three previous tr under a prior prosecutor, ende with hung juries.

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OW POINT When employees in the urgh office asked in March, 2005, er they would all have jobs in the and he had to say "No."

I TO TURNAROUND FAME Under sky, Kroll went from being $80 in debt with a market value of nillion in mid-2001 to being valued at $1.9 billion when Mac purchased it in 2004.

TION AFTER CEO STINT ENDS Return to public e or academia.

ONAL Enjoys reading, gardening, and following the tate Buckeyes.

t reverses outflows of investor money.

Cherkasky, who plans to spell out more of his plans for shareholders at a Dec. 7 investor day, could report more progress on brokerage revenues. He managed to stanch the losses by clocking n with flat revenues in the third quarter, n improvement over nearly two years of teady declines.

Marsh is battling a trend of larger firms losing business to upstarts. Integro Insurance Brokers has swiftly grown into a $50-million-a-year outfit by wooing such longstanding Marsh clients as Sun Microsystems, Stanley Works, Praxair, and PIMCO, industry sources say. Integro was founded in early 2005 by former Marsh president and 32-year company veteran Roger E. Egan, who says it's "doubly exciting" for him to compete against his old outfit, along with rivals Aon and Willis. With such competitors on the rise, Marsh's brokerage revenues from U.S.-based customers slipped 7% in 2005, to $5.2 billion, while No. 2 Aon suffered a 9% slide, to $2.7 billion, according to industry watcher *Business Insurance*. Fourth-ranked Willis Group Holdings saw a 2% rise last year, to just over $1 billion.

One thing Cherkasky is pointedly cool on is selling out to KKR and Willis. He insists MMC can do better for shareholders on its own. Sources close to the matter say KKR would like to merge Marsh and Willis, putting the smaller firm's managers in charge. KKR took then-struggling Willis private in a 1998 leveraged buyout and afterward reaped a $2.6 billion gain on its $305 million investment by taking Willis public again in 2001.

None of the parties would talk publicly about the KKR-Willis plans. But Willis CEO Joseph J. Plumeri is keeping the pressure on MMC's board. As recently as Oct. 26, Plumeri expressed interest in a "transformational" deal that would reshape his outfit. If KKR and Willis could come in with a rich price—one that intrigues even shareholders who bought in at 55—MMC's board would certainly pay attention. Of course, every quarterly improvement Cherkasky shows could make the price even more steep.

The CEO, whose contract with MMC lasts only until 2008, doesn't see himself as a lifer in the corner office. He'd eventually like to get back into public service or academia, but not because of the ups and downs he's been through with MMC. Those, he says, don't faze him. As a prosecutor, he got used to being reviled. "I've been called names my whole career." Still, one day he'd like to be called the guy who turned around MMC.

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A Real Power Negotiator

Jim Headlee got fired as a natural gas salesman. Now he helps clients win the best energy prices

BY DEAN FOUST

IN 1991, WHILE WORKING AS national sales manager for a natural gas marketing firm, James Headlee got a call from a customer, Georgia-Pacific Corp., complaining that his firm hadn't lowered its rates even though natural gas prices had dropped. After a little digging proved the client was right, Headlee suggested to his boss that they refund the overcharges and apologize. Two weeks later, Headlee was told he "wasn't with the program" and given just five minutes to clear out his office. "My wife had just had our fourth child, we were building a new home, and I sat in my car crying as I thought about how I was going to tell her I'd lost my job," says Headlee, now 51.

A few weeks later he realized that Georgia-Pacific likely wasn't the only company frustrated with the complex and opaque energy-buying process. Since states began deregulating natural gas rates in the late 1980s, many industrial companies had been struggling to choose from among the myriad gas suppliers that had sprung up. So Headlee launched a consulting firm in his Louisville home, becoming one of the first outfits to help corporations negotiate better rates for natural gas, and in time, electricity.

Headlee's privately held firm, Louisville-based Summit Energy Services Inc., now boasts $30 million in revenues and a stellar list of 128 corporate clients, including General Motors, Lockheed Martin, Pfizer, and, yes, Georgia-Pacific, for whom it negotiates a collective $12 billion in energy deals each year. About half of Summit's dozen or so national competitors are affiliates of large utilities, so Headlee's pitch to customers is that he offers unbiased advice. That distinction seems to resonate. "We value the fact they're independent and don't have a vested interest in the energy supplier we use," says Larry J. Pfeil, vice-president of engineering for Austin (Minn.)-based Hormel Foods Corp., which uses Summit to procure energy for more than 25 plants.

BUSINESSWEEK SmallBiz

Summit's independence has paid off in spades for both Headlee and his customers. The 175-employee firm doesn't contractually guarantee savings, but Headlee says clients reap an average of $3.90 in savings for every $1 they pay in fees. "That's actually a little low for us," says Jim Casadevall, head of global indirect purchasing for Livonia (Mich.-based TRW Automotive Holdings Corp which uses Summit to buy energy fo its 40 North American plants. In sum Summit has saved its customers mo than $1 billion, often by playing sever suppliers off one another to wring ou the best price.

Not that success was a given. Heac lee's first clients were a couple of sma municipalities that couldn't afford t pay him more than $500 a month. Bu Headlee got his break in 1993 whe Kansas City (Mo.)-based Dairy Farme of America signed his fledgling firm t manage energy at its 30 facilities. Soo after, his noncompet agreement expired an Headlee began courtin Georgia-Pacific and othe clients of his former firn

HEADLEE The personal touch, with clients and employees

TAP ON IN

AS ITS CUSTOMER roste grew, Summit expande to include such servic as hedging strategie auditing bills for error and reviewing plant op erations for cost saving "Our competitors don have the depth of se vices we now do," say Headlee. For one maj manufacturer that wa unhappy with its hef natural gas bills, Headle suggested it threaten t bypass the supplier an build its own tap int the interstate gas pip line. That shrewd pl prompted the utility t slash its delivery ra from 68¢ to 9¢ per mi lion cubic feet of gas.

Headlee is keen on gi ing personal attention t his staff as well. When hiring, he seel people with strong character and inte rity and then teaches them about th energy business. On each employee anniversary, he writes a personal lett noting the individual's specific contrib tions. Earlier this year, Summit acquire a European company to better work wi global clients, and Headlee welcome each of his 80 new employees wi a handwritten note. Headlee's form employer has heard from him, too. Soc after he launched Summit, Headlee, devout Christian, sent his old manage a letter saying he had forgiven them. H might have sent a thank-you note. ■

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Want Some Pajamas With That Kayak?

L.L. Bean must invigorate brick-and-mortar sales, and big-ticket items aren't the answer

FEWER FRILLS Burlington's new Bean

BY AARON PRESSMAN

THE NEW L.L. BEAN STORE in Burlington, Mass., its first in four years, might be most noteworthy for what's not inside. Unlike its 160,000-square-foot flagship store in Freeport, Me., or the larger stores of some of its rivals, L.L. Bean Inc. decided against grand visual gestures like a fishing pond or climbing wall. Even much of the gear that the cataloging giant made famous, like duck boots and down-filled sleeping bags, has been relegated to a lower level. Instead, the emphasis at this suburban Boston outpost is on apparel, with plenty of brightly colored women's sweaters and kids' pajamas occupying the prime real estate up front.

The formula seems to be a hit, judging by the packed parking lot and long checkout lines on a recent chilly Saturday. That's a relief to Bean. Its initial retail foray outside Maine in 2000 was a disaster. Set in the upscale Tysons Corner Center mall in McLean, Va., the store was chock full of kayaks and hunting gear and featured live trout fishing demonstrations. Shoppers yawned, and big-ticket items barely budged. By 2002, Bean's chief executive, Christopher J. McCormick, who declined to speak to *BusinessWeek*, had halted retail expansion in order to regroup. The recalibrated retail experience, including a makeover of the Tysons Corner store, jibes better with what the wealthy suburbanites it's targeting actually want to buy.

NEW ENGLAND INVASION

THE STAKES ARE EVEN HIGHER for L.L. Bean to get it right this time around. The company's catalog still kicks in most of its sales. Retail, including outlet stores, accounts for just 20%. But that may well change. For retailers as a whole, catalog sales have been stagnant for more than a decade. Customer response rates have declined while postage and printing costs have leapt, explains Polly Bickel Wong, senior vice-president of strategic services at consulting firm Belardi/Ostroy ALC in New York. "Retailing is the fastest and most scalable way to grow now," says Wong, who oversaw expansion plans while working at Williams-Sonoma Inc.

What's more, L.L. Bean's new effort, which will add 25 more stores through 2010, comes as upstarts threaten to encroach on the New England icon's home turf. Once the unquestioned leader of outdoor retailers, L.L. Bean, with $1.5 billion of sales last year, ranked third behind Springfield (Mo.)-based Bass Pro Shops Inc. and Sidney (Neb.)-based Cabela's Inc., according to market research firm SportsOneSource. The two pacesetters—which both started as mail-order outfits, too—have been growing quickly, mostly in the Midwest and the South, their cavernous stores festooned with museum-quality stuffed animals, indoor waterfalls and ponds, and gigantic wildlife murals. Bass Pro, with 37 stores and plans to add 6 to 10 a year, will open its first Massachusetts outlet next year. Cabela's wants to open a store in Scarborough, Me., just 25 miles from L.L. Bean's flagship.

Clearly, L.L. Bean's previous brick-and-mortar stumble gave competitors an opportunity. Cabela's sales, for instance, have grown 67% since 2001, to $1.8 billion. By contrast, L.L. Bean's sales have increased just 23% over the last five years. (The privately held company would not disclose more financial information.) "There're risks for L.L. Bean opening stores, but the biggest risk of all would be not to do it," says retailing guru Howard Davidowitz, chairman of Davidowitz & Associates. "Their core business is under attack."

The store push will start in markets close to headquarters, in New England, New York, and Pennsylvania. Like the Burlington store, which opened on Sept. 15, the new locations will be small relative to competitors and will feature seasonal clothing. Even the Freeport flagship store has moved its hunting, fishing, biking, and boating departments to satellite stores to make more room for clothing. Under McCormick, the first company chief not related to Leon Leonwood Bean, the company won't be pitching as much anymore to the true outdoorsmen—unless they're in the market for sweaters and pajamas. ■

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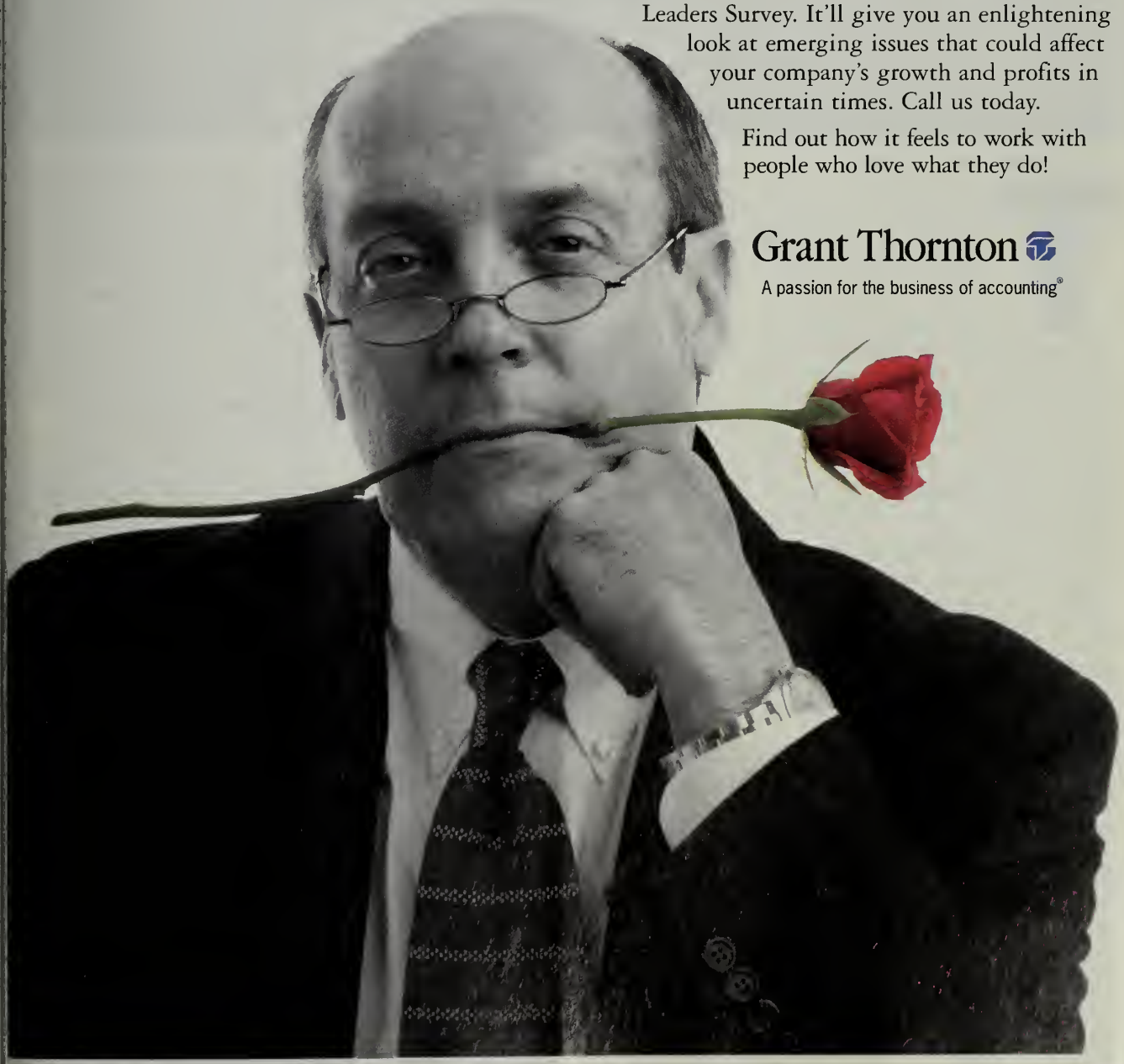

Labor Ready Rolls Up Its Sleeves

The nation's largest provider of day laborers faces profit pressure as the construction boom slows

BY CHRISTOPHER PALMERI

THE DAY BEGINS EARLY at Labor Ready Inc. It's still dark at 5:30 when branch manager Yobani "Geo" Galvez swings open the security gates at the company's storefront on Hollywood Boulevard in Los Angeles. Soon a half-dozen men are waiting in the brightly lit room, drinking free coffee and gazing sleepily at a workplace safety video playing on a small TV. More men wander in as Galvez and his assistant sift through orders from the day before and answer phone calls from companies requesting part-time help.

The men in the waiting area—black, white, and Hispanic—have worked in construction, manufacturing, and restaurants. Steven Baker, 46, is just out of prison. "I'm trying to get back on my feet," he says. Soon he and 21-year-old José Castellon will join two other men doing home remodeling work in the Hollywood Hills. "That's what I like about Labor Ready," Castellon says. "They always send you out."

It's Labor Ready's motto: "We put people to work." Since its founding 17 years ago, the company has become the nation's largest provider of day laborers, cutting checks to more than 600,000 people a year. It charges employers about $13.50 an hour and pays its workers about $7.50, minus their share of taxes. Based in Tacoma, Wash., Labor Ready has 926 branches in the U.S., Britain, and Canada, with $1.2 billion in sales last year. Over the past three years, its net income has more than tripled, to $63 million, winning the firm a place in *BusinessWeek*'s annual Hot Growth ranking.

Staying there will not be easy, though. Labor Ready has benefited mightily from the boom in home construction and remodeling, which accounts for about 40% of its business. In some markets, particularly Florida after last year's hurricanes, contractors had open orders for Labor Ready to send them every worker it could find. But new-home construction has fallen off sharply, and with it Labor Ready's near-term earnings prospects.

HOT GROWTH COMPANIES

Chief Executive Steven C. Cooper has had to ratchet back Wall Street's earnings expectations to the low end of his guidance for the year. Profits are still expected to be up about 16% for 2006, to $71 million, but next year is cloudier, and the company's stock is down 35% since April. Because of the short-term focus of the work, Labor Ready's day workers "are the first people to get laid off if things start to slow," explains Michael D. Carney, an analyst at stock research firm Aperion Group. "They're looked at as a leading indicator."

Many of the jobs consist of unloading trucks, digging ditches, and cleaning up debris—or as Stacey Burke, communications vice-president, puts it: "Here's a sledgehammer, there's the wall." Job candidates are given a 20-minute quiz designed to weed out those who have problems with drug, anger management, and other workpla hazards. And all must prove they're the country legally. Red flags can lead a drug test.

SHOW BUSINESS: A Labor Ready worker helps build the stage for a party in Hollywood

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HOLLYWOOD STARS

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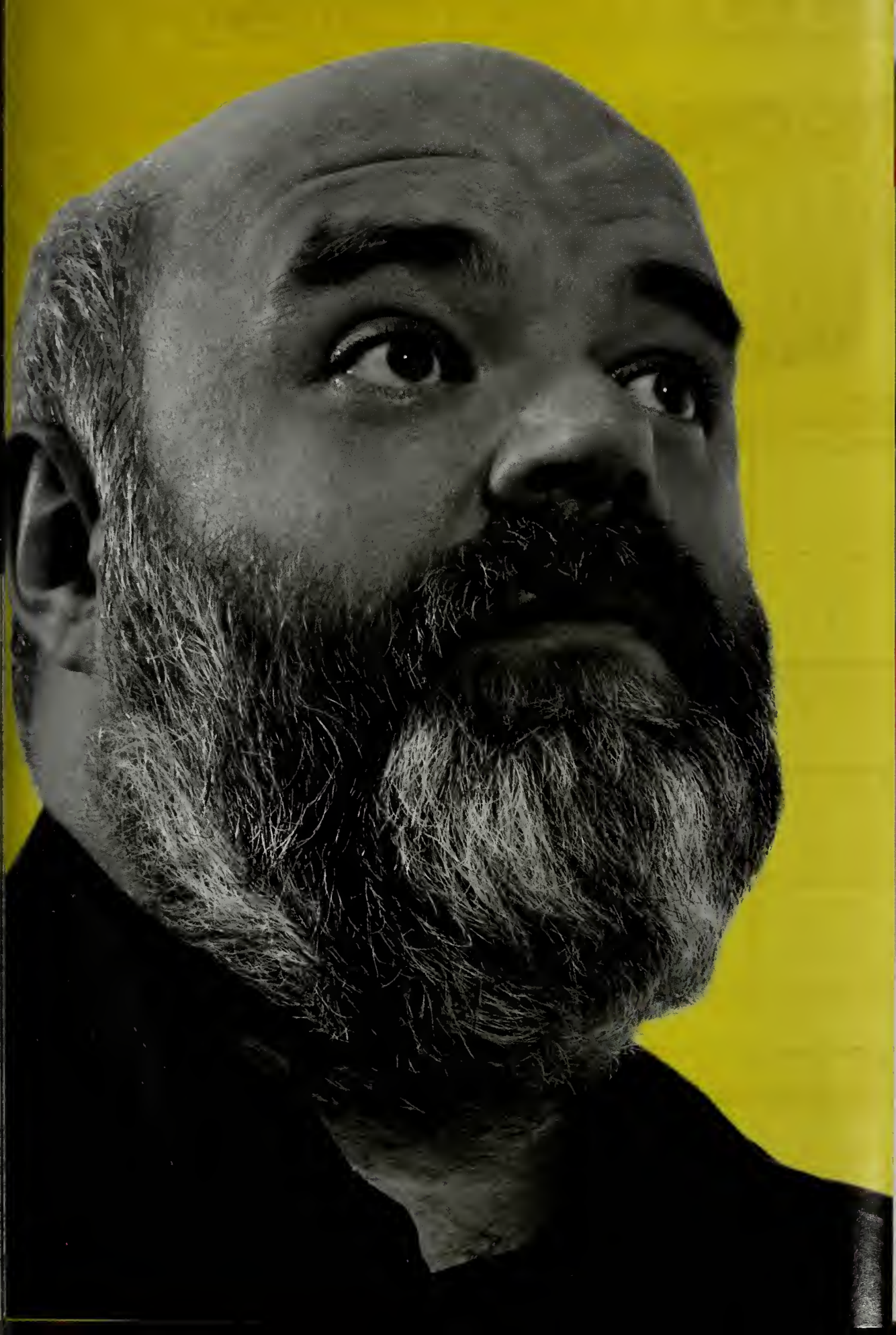

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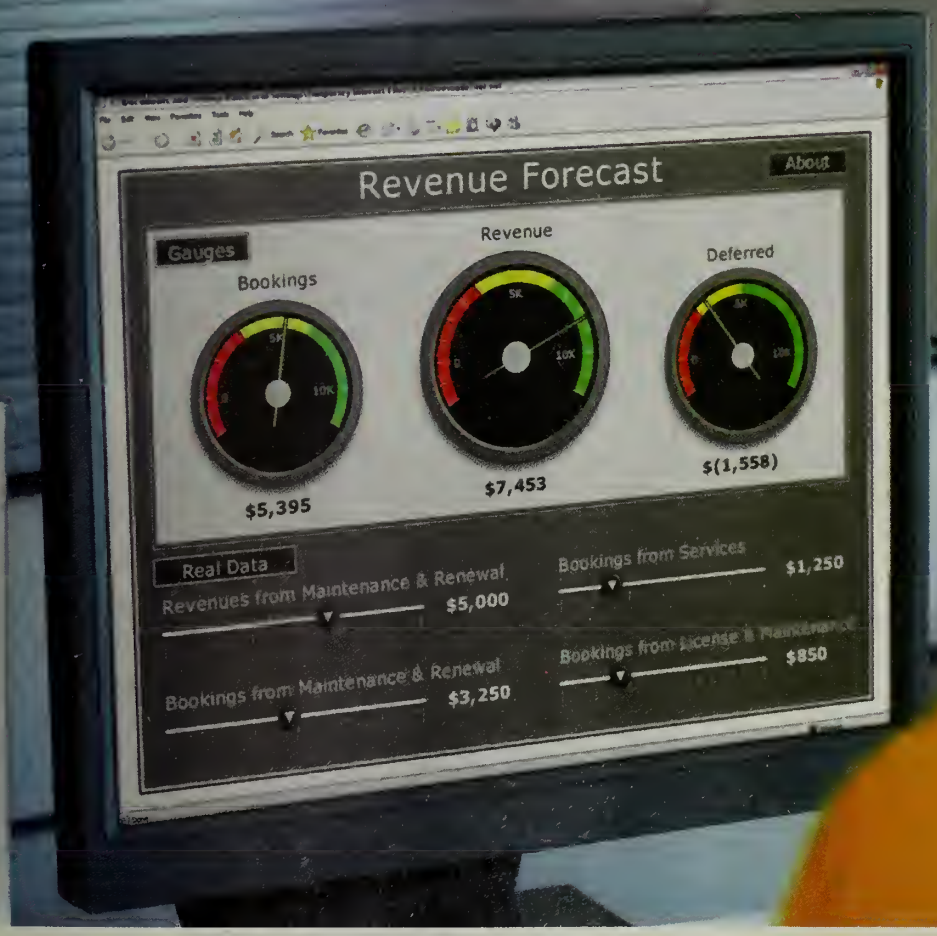

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The nation's largest provider of day laborers faces profit pressure as the construction boom slows

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Thousands of midsize companies run SAP?

Galvez has helped boost revenues there to an annualized rate of $1.4 million this year, up from $900,000 last year, and on a par now with the company average. Galvez is plenty motivated. Branch managers start at $36,000 a year but collect 10% of their branch's profits, which can push their total compensation into six figures at top-performing locations.

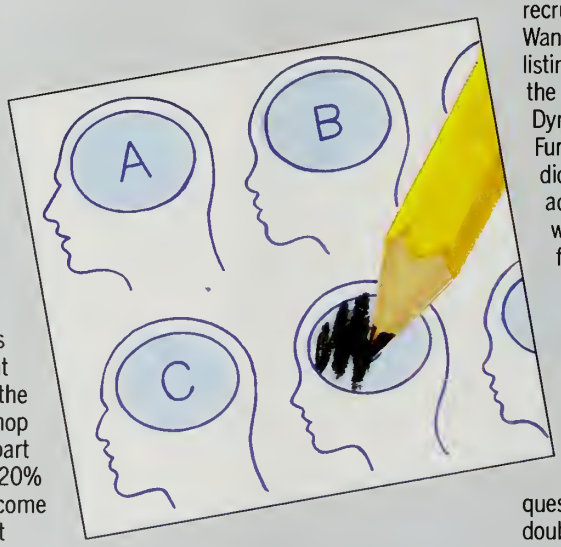
Galvez says he gets his best results from companies that are already customers, such as George C. Hopkins Construction Co., a contractor working on the Broadway Hollywood Lofts, a high-end residential project at the corner of Hollywood and Vine. He has hired out dozens of workers at similar construction sites in the slowly gentrifying neighborhood. "These guys are the real stars of Hollywood," he says of the workers. When making sales calls, Galvez doesn't mention that Labor Ready is traded on the New York Stock Exchange and has more than $1 billion in sales. "They'd think we're charging too much," says district manager Thomas Stonich.

On a recent October afternoon, Galvez appears in the office of Hollywood Lofts project manager David Lee with a big box of donuts in hand. He and superintendent Steve Turko joke about the tickets to a NASCAR race Labor Ready provided this past summer. Lee says his staffing demands fluctuate wildly. Some da needs as many as 15 temps, some none. "I can go down to Home and pick up people," he says, "but I need cash to pay them. I need rec Labor Ready does all that for me."

Lee now has two former Labor workers employed full-time on th One, 27-year-old Michael Brown, he's hoping the experience will him decide which construction he'll ultimately settle on as a profe "Sure we're dependent on the eco but we're in business to help busin grow," Cooper says later. "That's n ing to end." ■

HEADHUNTERS

Putting Managers To the Test



Even as Labor Ready struggles with flagging demand for its workers, another human-resources company on *BusinessWeek*'s Hot Growth list is on a tear. Los Angeles-based Korn/Ferry International is at the opposite end of the pay scale, and its 450 headhunters are well-positioned for the global talent hunt, resulting in a 25% sales jump in the latest quarter. Helping top executives hop from one company to another is only part of Korn/Ferry's role these days. Some 20% of the firm's $500 million in revenues come from fast-growing side businesses that provide online tools to help clients evaluate and recruit middle managers.

Zurich Financial Services, Harrah's Entertainment, and Sun Microsystems have all enlisted Korn/Ferry to perform such tasks as figuring out who to keep and who to let go after major mergers or planning for the retirements of senior managers. Such tasks involve both assessing and coaching internal candidates. Korn/Ferry Chief Executive Paul C. Reilly hopes the unit that provides these services will account for an even larger share of the company's sales in the next few years. "We're becoming a very different firm," Reilly says. "Everyone talks about the 50 million baby boomers retiring. Companies have to focus not just on finding talent but retaining it."

The heart of Korn/Ferry's new business is an electronic questionnaire that takes about an hour to complete. To grasp your natural management style, it presents a hypothetical situation. The company is going to move you from headquarters to a subsidiary in a small town, say. The pay will be less than you make now but could rise with bonuses. The previous manager was well-liked by his staff even though he made tough decisions. Your profile, on the other hand, says that you solve problems by taking entrepreneurial actions and placing risky bets. A strike is now brewing at the plant, and Human Resources wants a leader with a firm hand. Does this transfer to the plant constitute a reprimand to you, or is it meant as encouragement? "There are no right or wrong answers," says Gary Hourihan, who heads Korn/Ferry's manager-evaluation business. "The behavioral and cultural fit is the major derailer of careers today. What works at I might not work for Microsoft."

Ironically, Korn/Ferry's questionnaire has its roots in a dot-com flop. In 1998 the company launched Futurestep, an online recruitment site for middle managers. Wanting to be more than just a résumé listing service, Korn/Ferry partnered with the management consulting firm Decision Dynamics to develop the online evaluatio Furturestep's original business model didn't work. The company found that advertising to bring in online résumés was too costly. And clients still wanted face-to-face interviews, something tha required a lot more time and manpow than the lower-level jobs paid in recruiting fees. Today Futurestep contracts out with companies only on larger assignments, say to hire 5 store managers for a big retailer's expansion or to take over the entir recruiting efforts of a company. Th questionnaire lives on, though—a sign, no doubt, of Korn/Ferry's flexible managemen

Having that history helps. Hourihan says Korn/Ferry has collected more than 1 million profiles of managers over the past six years. By cross-referencing basic data such as salaries and titles with the more nuanced answers to the questionnaire, Hourihan's team has figured out which managers end up being the most successful executives. It's not the command-and-control types of old who make it to the top, he says. It's team-oriented leaders who gather information from multiple sources. Decision-making styles also evolve over the course of an executive's career, from direct, fast, and firm in the early stages to a more inclusiv exploratory approach at higher levels. "That's the formula for success in the Western world," Hourihan says.

–By Christopher Palm

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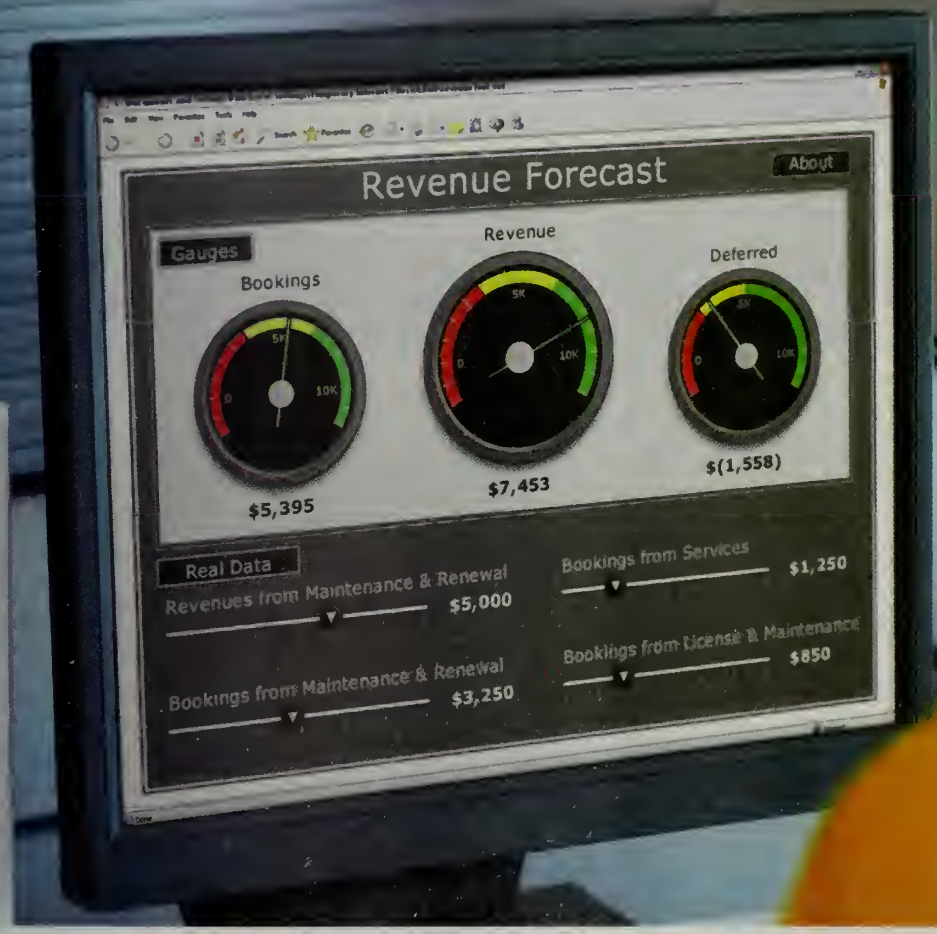

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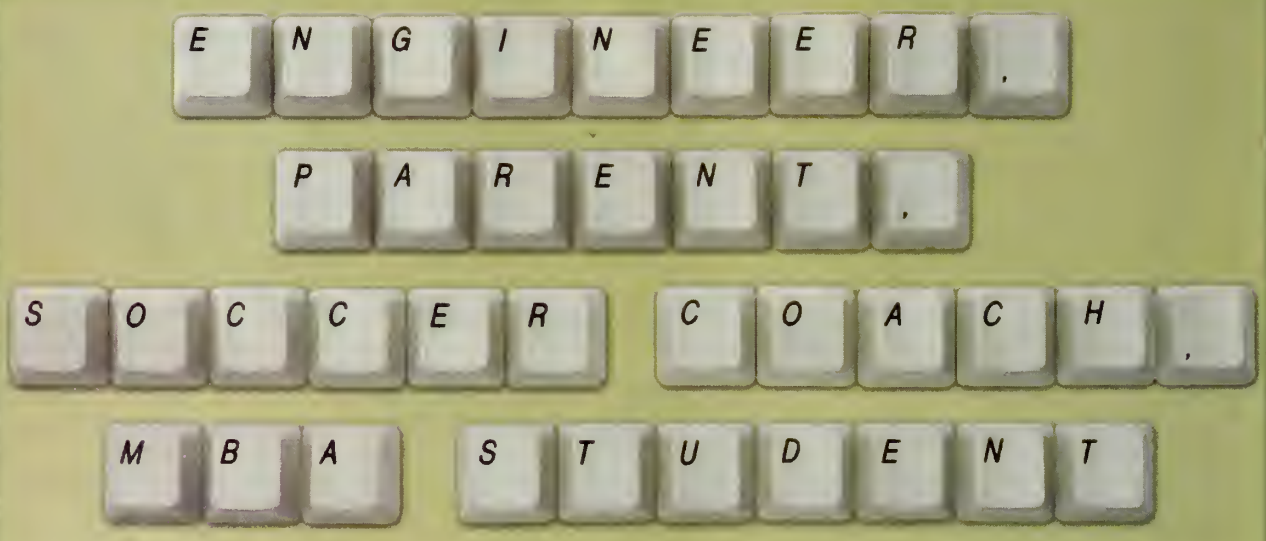

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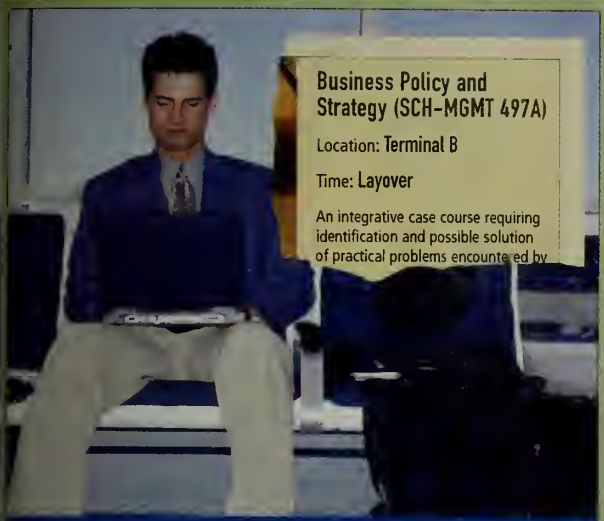

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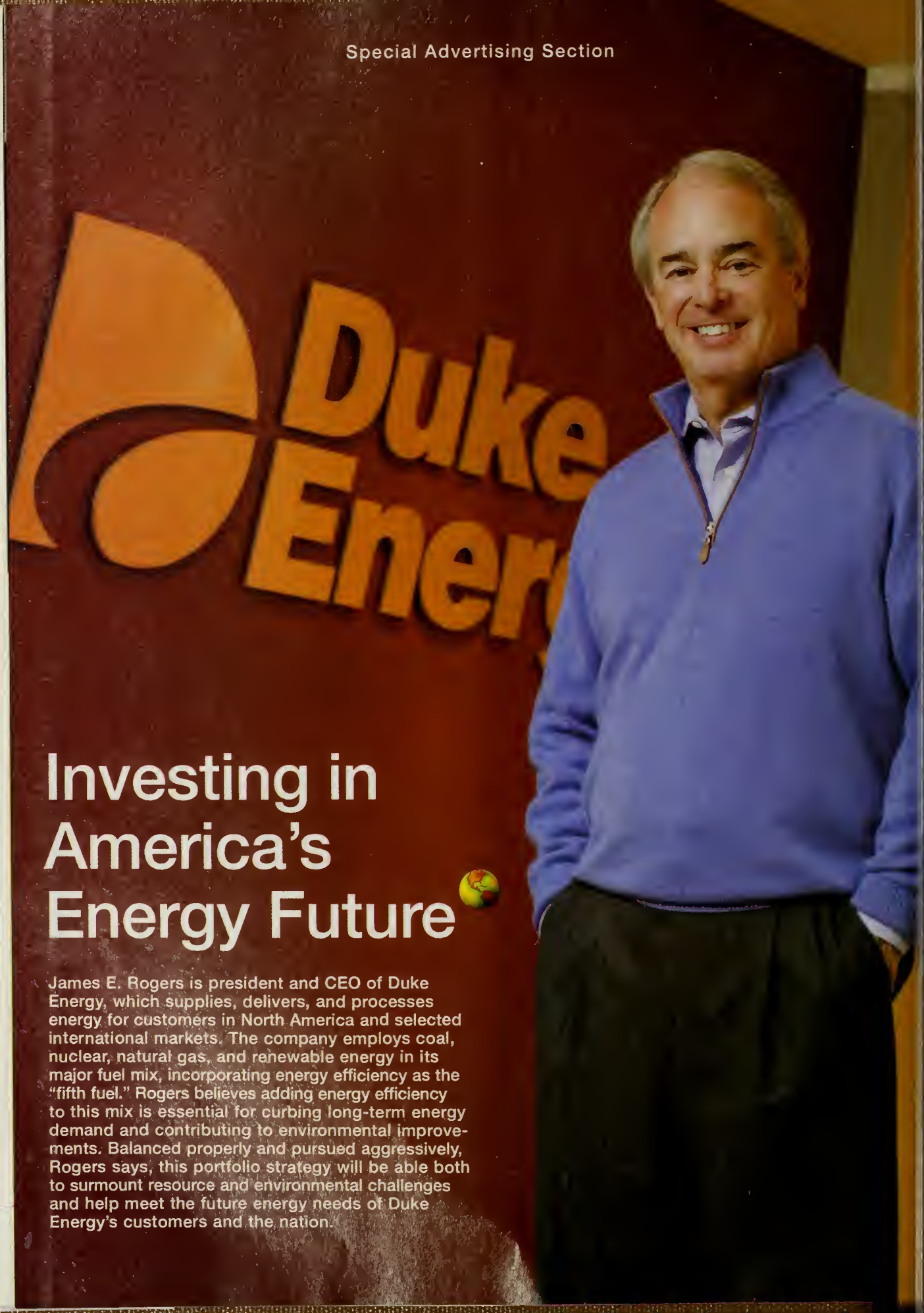

Investing in America's Energy Future

James E. Rogers is president and CEO of Duke Energy, which supplies, delivers, and processes energy for customers in North America and selected international markets. The company employs coal, nuclear, natural gas, and renewable energy in its major fuel mix, incorporating energy efficiency as the "fifth fuel." Rogers believes adding energy efficiency to this mix is essential for curbing long-term energy demand and contributing to environmental improvements. Balanced properly and pursued aggressively, Rogers says, this portfolio strategy will be able both to surmount resource and environmental challenges and help meet the future energy needs of Duke Energy's customers and the nation.

Finding the Power

Developing resources to fuel the U.S. grid

The power sector is often taken for granted in the U.S., where the simple flick of a switch allows us to bask in the glow of our favorite lamp or TV show. Americans forget that their electrical socket is really a connection to a complex machine, and that the machine must be fed to work. Over the years, electricity has been generated by everything from wood and whale oil to nuclear plants and wind turbines.

Some 40% of the energy consumed in the U.S. is used to generate electricity. The hungry system that brings civilization into our homes and offices is an interconnected matrix of generation, transmission, and distribution designed to turn black rocks, liberated gases, fissile minerals, falling water, sunlight, and even wind into electricity and distribute it down the lines.

This giant matrix will need to produce 50% more power in 2025 than today. With power accounting for 40% of CO_2 emissions, another challenge is to produce it cleanly. "Sustainable energy efficiency and conservation must be part of the larger effort to meet the growing demand for energy in this country. We see great potential here to better serve our customers and communities," says James E. Rogers, president and CEO of Duke Energy.

From coal to natural gas and even nuclear energy, resource prices are an issue, while renewable energy has made significant technological advances. It's a safe bet that a snapshot of today's energy mix will be visibly dated within a generation.

Going Nuclear

About a quarter of the world's 440-plus nuclear plants are in the U.S., although no new nuclear plants have come on line since 1996. According to the Department of Energy, nuclear power accounts for 12% of the nation's generating capacity, but 20% of its daily electricity.

Recently, public and policy support for nuclear energy have strengthened. Last year, President Bush signed a bill supporting loan incentives for all power plants that do not emit greenhouse gases, and production tax credits and federal business-risk insurance for nuclear plant builders. Affirms Frank L. Bowman, president and CEO of the Nuclear Energy Institute: "There is clear recognition that America needs clean energy that provides reliable, abundant electricity."

Back to the Future Concerns about climate change and dependence on foreign energy sources sparked an initiative to develop new nuclear power plants.

The Nuclear Power 2010 Initiative is a $1.1 billion partnership between the Department of Energy and industry to test the Nuclear Regulatory Commission's new licensing process for nuclear plants. The program is seen as critical to expanding nuclear

A Letter from Samuel W. Bodman, Secretary of Energy

BusinessWeek's informative series, "Investing in America's Energy Future," has brought much-needed attention to the need to strengthen our nation's energy security by diversifying our energy supply. Specifically, we must move away from a hydrocarbon-based economy toward alternative and renewable energy. At the U.S. Department of Energy (DOE), we are working to foster an energy transition that will enhance our economic and national security and protect our environment.

The fact is that over the next few decades, demand for energy in the U.S. and around the world will grow exponentially. And in order to sustain the world's strong economic growth, we must find ways to generate more electricity cleanly, deliver that electricity safely, and use our electricity more efficiently. To help expedite such transitional change, President Bush proposed his Advanced Energy Initiative (AEI), which includes a 22% funding increase in clean energy research at DOE to accelerate the production of alternative and renewable energy sources such as biofuels and solar, wind, and nuclear energy.

In addition, the Department of Energy and the federal government are able to provide a variety of incentives for both consumers and industry. In addition to a wide variety of consumer and industry tax incentives that are part of President Bush's Energy Policy Act, the DOE recently announced it can provide up to $2 billion in loan guarantees to encourage investment in creative and novel energy technologies. In addition, we are making $250 million available for the construction of two new bioenergy centers that will expand production of cellulosic fuels. And, the DOE will provide up to $2 billion in risk insurance to protect against losses associated with bureaucratic and legal delays for the next six nuclear reactors that are built. But while the government can do a lot...we can only do so much.

The real development will come from capital investment, entrepreneurs, and American ingenuity. Our nation is home to some of the greatest minds in the world, and by working together we can build a more secure energy future for the U.S. and our families—one that will wean us from foreign influence and allow our economy to continue to prosper.

Again, i thank BusinessWeek for producing this series and for highlighting our nation's energy security.

Sincerely,

Samuel W. Bodman
Secretary of Energy

Investments

in biofuels, solar, wind, hydrogen, natural gas.

We plan to invest $500 million over the next 10 years in biofuels research. We're aiming to invest up to $8 billion over 10 years in BP Alternative Energy, an initiative that expands our solar, wind, hydrogen and natural gas activities to provide low carbon electricity.
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BP Alternative Energy:

High Energy for Low-Carbo Power

Around the world, the demand for energy – especially electrical power – is rising dramatically. The combined forces of growing popu lations, burgeoning industry in developing countries, and new electrical applications are placing a huge burden on commercial powe businesses and government policy makers. Their challenge is to find new energy sources that can suppo the world's needs – cost-effectively, reliably, and responsibly.

BP, a global energy group with a commitment to environmental responsibility, is leading the way. In creating BP Alternative Energy, on of the world's first businesses dedica ed to the development and wholesa marketing and trading of low-carb power, BP is defining a strategy for developing new solutions to meet industry demand.

That strategy is anchored in BP's belief that the only sustainable approach to electricity production involves multiple forms of power generation – including solar, wind, hydrogen power with carbon captu and storage, and gas-fired power generation. When BP Alternative Energy was launched a year ago, the company announced plans to invest $8 billion in low- and zero-carbon power technologies over the next decade.

Already, BP Alternative Energ is on the move. This year alone, the company purchased Greenlight Energy Inc., a U.S.-based develope of new and mature domestic wind projects, and entered into a strategi alliance with wind energy compan

Clipper Windpower that will support five wind farms in the U.S. and provide wind turbines for its global business. In the hydrogen market, BP and GE have announced plans to jointly develop and deploy hydrogen power projects that will dramatically reduce emissions of carbon dioxide from electricity generation. In solar, BP Solar has developed a new silicon growth process, called Mono2, which

This is a Clipper wind turbine.

significantly increases cell efficiency over traditional multicrystalline-based solar cells and will greatly improve wafer quality and reduce production costs.

These initiatives are just the beginning. By forming partnerships and investing in innovative approaches and technology, BP hopes to drive progress toward a well-known industry goal: creating a 20% penetration of alternative energy into the global power market in just 20 years. "Although BP is a huge company, we realize we can't succeed alone," explains Christopher Hunt, head of the global power business for BP Alternative Energy. "We view the development of alternative energy as a collaborative effort with utilities, technology innovators, and government. We look forward to building on these partnerships to meet our goals, while responsibly and successfully serving the world's growing energy needs."

Because we think it's important to diversify, too.

Building a diverse portfolio is one way we're investing in the new energy future. Over the last 5 years, we've invested $30 billion in U.S. energy supplies, like cleaner burning natural gas.
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power, as is legislation proposed to help complete a nuclear waste repository at Yucca Mountain, Nev. "The support we're seeing from the Energy Policy Act of 2005 is unprecedented in our industry," says Bowman.

The nuclear industry's new-found momentum is due in part to improved economics. Ten firms own more than 60% of the industry, consolidation that has led to improved management and efficiencies. With almost 70% of U.S. electricity being generated by fossil fuels, the nuclear alternative appears promising. "The fact that 13 companies or consortia are seriously considering filing license applications to build up to 30 reactors is the strongest signal that nuclear energy is competitive in the marketplace," says Bowman, who commanded the U.S. Navy's nuclear fleet.

Areva, General Electric, and Westinghouse do everything from designing and building plants to supplying their parts. The industry believes it could add 30 or more nuclear plants by 2030. "It's important that we get the ball rolling today if we're going to meet the future electricity needs of America," says Bowman.

Natural Gas on the Rise

Roughly 70% of electricity in the U.S. is generated using some fossil resource. The U.S. consumes 22 trillion cubic feet of natural gas per year, with 23% of that generating a sixth of our electric power. Demand is forecast to grow by 22% by 2030, according to the Department of Energy. Some natural gas-fired power plants can emit as much as 50% less carbon than a conventional coal plant, and natural gas is relatively abundant worldwide (though nearly 75% of the world's reserves are located in the Middle East and the former Soviet Union).

Recent price swings highlight gaps in the system that some are hoping can be filled by the expansion of domesti supply and the liquefied-natural-gas infrastructure. Its low-carbon content relative to oil and coal also augur that gas will become an even bigger part of the U.S. energy mix. "Natural gas is probably one of the better low-carbon power options available to the world today," says Christopher Hunt, heac of the global power business for BP Alternative Energy.

Many see promise in liquefied natural gas (LNG). Frozen to liquidity, it has less volume and is cheaper to transport. Trade in LNG has occurred for 40 years. By embarking on an energy diet that includes it, the U.S. joins a global market that resembles the petroleum market. In 2002, LNG accounted for 1% of gas supply; by 2020, the number could be dramatically higher. Says BP's Hunt: "Foı those looking at the long term, natural gas is one of the mos critical parts of the power mix." He adds that gas should retain a 25% to 30% share of the U.S. power mix.

The Once and Future King: Coal

The U.S. is often referred to as the Saudi Arabia of coal, with a 250-year supply. Some 53% of the U.S.'s (and 40% o the world's) electricity is generated using coal, the dominan player in power generation.

Taking advantage of the U.S. abundance of coal means creating new technologies. Two potential solutions — clean coal technologies (CCTs) and carbon sequestration — are beinı developed via public/private partnerships. CCTs sharply reduce emissions and pollutants from coal-burning plants by "gasifying" the coal, increasing efficiency by extracting more energy from less fuel. In carbon sequestration, CO2 is captured and stored, or "sequestered," underground in geologic formations. Carbon sequestration is being demonstrated in a variety of projects around the globe, including BP's project in In Salah, Algeria, and the Department of Energy's project in Weyburn, Canada.

Another development: hydrogen can be produced using diverse, domestic resources including fossil fuels (with carboı sequestration), nuclear, and renewable energy technologies. "Hydrogen shows perhaps the greatest potential for growth and contribution longer term," says BP's Hunt. "Coal is one of the cheapest, most abundant energy sources. If we can work to incorporate it with carbon sequestration, hydrogen power

New Technologies for Old Systems Coal, which is abundant in the U.S., benefits from clean coal technologies (left). New ways to transport natural gas, such as innovations in liquified natural gas, keep it a viable source of energy (right).

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has the potential to overshadow other low-carbon alternatives." BP has announced plans for a hydrogen power plant with carbon capture and sequestration in Carson, Calif.

Renewables Gain in Oil's Wake

The U.S. currently imports 59% of its oil, versus 33% in 1973. Three percent of U.S. electricity generation still comes from oil. Still, while oil's role in electricity generation is shrinking, some predict that oil-based power plants will remain, if only to supply electricity periodically, during high demand. Says Hunt: "The U.S. always has a need for plants that serve peak demand, and it often doesn't make economic sense to build a new coal or gas plant for that purpose."

A large share of extra power may come from renewable resources that are naturally replenished and recurring, whether sunshine, wind, ground heat, growing matter and wastes, or even tides. Investors large and small are capitalizing on these green technologies.

Demand for solar power has grown 30% annually over the past five years. California's recent passage of the "million solar roofs" bill is expected to increase the country's largest solar market, aiming at the equivalent of six large power plants.

BP Alternative Energy has its own solar business focused on harnessing the sun's energy to produce solar electricity. This includes the design, manufacture, and marketing of solar electric systems for a wide range of applications in the residential, commercial, and industrial sectors. BP Solar is one of the world's leading solar companies, with manufacturing facilities in the U.S., Spain, India, China, and Australia.

Wind energy was the nation's fastest-growing energy source in the 1990s, and the growth continues, driven by a combination of technological improvements and favorable economics.

BP Alternative Energy and Clipper Windpower recently announced a long-term turbine supply agreement and the joint development of five of Clipper's wind energy projects in Texas, South Dakota, and other states. Under the agreement, BP secured a mix of orders of up to 2,250 MW of additional Clipper turbines in its global wind portfolio. BP also recently purchased Greenlight Energy, a large U.S. developer of wind projects, ensuring BP a substantial portfolio of wind projects over the next several years.

Energy based on water is a large and growing sector. The new frontier: ocean power and smaller hydropower technologies that do not require dams or diversions but take advantage of tides, waves, or currents. Says Sean O'Neill, president of the Ocean Renewable Energy Coalition: "The challenge ahead will be focusing federal and state resources on supporting clean, sustainable energy from our indigenous ocean resources."

As Americans confront the need to produce more energy more cleanly, technologies and good ideas are proliferating. One thing is certain: the U.S. does not want for options.

Walking on Water New developments in harnessing the power of water are focused on free-flow hydropower such as tides and ocean waves, as opposed to dams or diversion systems.

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James LoGerfo is the founder of Vortex Energy LLC, a strategic advisory firm serving energy technology companies and investors. He is also a managing director of Bovaro Partners, an investment bank offering corporate finance and M&A services to traditional and alternative energy companies.

In the Trenches at VF Boot Camp

A skeptical reporter attends the apparel maker's Leadership Institute and comes out a believer

Y NANETTE BYRNES

THERE WERE SIX OF us, squinting down the length of a conference table at a single laptop. It was past 9 p.m., and what we could make out on the screen wasn't encouraging. We'd all met just 13 hours earlier—when I was thrown together with five fast-climbing executives at apparel maker VF Corp. for an exercise in management boot camp. Over the four days of the Leadership Institute, as VF calls it, we would face more important challenges, but what had us all flummoxed at the moment was a computer game at which we were failing spectacularly.

I'm a dyed-in-the-wool HR skeptic. So after a day of lectures on communication—and tossing around Nerf footballs to "loosen up"—I wasn't so sure why we were puzzling out "Launching a High-Risk Business," a simulation cooked up by two Harvard Business School academics. Another of our band, Rob Purvey, echoed my doubts. An executive at skateboard shoe brand Vans, Purvey had once been an entrepreneur himself and had raised $30 million of the real green stuff for one venture. We tried strategy after strategy. They all failed. But about a half-hour before our 10 p.m. deadline, something clicked. We partnered with the inventor, poured cash into marketing, and begged every virtual venture capitalist and bank for seed money. The offers started to trickle in, and soon our company was worth $5 million. We actually whooped with joy.

Score one for team bonding. Up to that point, sitting in that windowless, fluorescent-lit conference room, I'd wondered whether VF could possibly get enough from this program to justify taking 19 of its best people away from their day jobs for a week. As a reporter, I'm used to being an observer, operating solo. But when our fortunes turned that night, I was as elated as anyone else. That video game had broken down the normal reserve any group of distant colleagues would have, especially one with a journalist in its midst.

HR HEADACHES

THE TASK OF team-building has grown more complex lately for VF Chief Executive Mackey J. McDonald. The company, long known as the maker of traditional jeans brands Wrangler and Lee, has recently taken on a number of more fashion-forward brands, including Reef surfer wear, Vans, and The North Face outdoor gear. Hence the HR headache: getting the most out of a workforce of 52,500 employees spread over 40 dif-

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PLAYBOOK: BEST-PRACTICE IDEAS

How to Get the Most Out of Management **Training**

BE OPEN

The most valuable thing you learn may not even be on the curriculum. Michael Corvino had been meeting for years with company brass and was well on his way to a promotion when he spent a week at VF's boot camp in 2004. He learned how important it is for a leader to listen. That helped him make the transition the following year to a new job as president of VF's JanSport.

MAKE CONNECTIONS

Being thrown together with a bunch of strangers has its good points. For executives at a company like VF—which has 12 separate divisions headquartered in 10 states, plus outposts in 39 other countries—it's a chance to bond with far-flung colleagues in a setting that affords more meaningful interaction than, say, a divisional cocktail party.

DON'T ENTIRELY IGNORE THE DAY JOB

If you can keep your BlackBerry in its holster most of the time, you'll get more out of the meeting. But some business must get done. Ray Nadeau, presiden of mass channel for VF Intimates, had to take off one day for a command performance at Wal-Mart. He was back in time for the executive dinner that night.

ferent countries. But McDonald is doing something right: Good sales and profit growth at the $6.5 billion company have helped its stock return 47.6% over the past year. And the attrition rate for its top performers, both homegrown and acquired, is less than 5%.

Indeed, one of the goals of the Leadership Institutes, such as the one I attended in October, is to get top managers from all different parts of the company working together. Its "final exam" is a 45-minute, case-study presentation to McDonald, President Eric C. Wiseman, and other top brass. Four teams compete. A quarter of the graduates are promoted within 24 months. So it's no surprise that with so much ambition around, the atmosphere was at times intense and competitive. My team got an inkling of the challenge over beers after our late-breaking triumph at the computer game when we learned that the winning team had built a simulated company worth $100 million, twenty times the size of ours.

The next day, undaunted and even invigorated by our small victory, my teammates and I found ourselves on a luxury bus zipping off to an afternoon of research at a couple of local golf courses. In our laps was a case study, which would pose the session's capstone challenge: to kick-start the sportswear division of a company, beginning with the launch of a new golf apparel line.

We all had the same challenge, and the same research opportunities, but the four groups came up with completely different solutions. My team pitched a line of apparel for kids and parents to golf in together. The idea was to transform g from something that split Dad from t family to one that brought them all t gether. Our field research on Wednesd was followed by a marathon Thursd working on our presentation. I was t busy to dwell on my growing hatred f our glum conference room, where had all spent too much time over the bo camp's four days.

On the final morning, my team p sented first. But not long into the thi team's highly polished presentation, r heart began to sink. It seemed as if th had found another 24 hours to practi their parts. They had the most standa idea of all the teams, going after you men with a more fashionable look. T other two teams had zeroed in on wom and environmentally-conscious urba ites. But the eventual victors had us the skills of each of their five presente better than the rest of us. A marketi guy led the pitch, a dealmaker fr the corporate M&A group presented t financial argument, and a jeanswear v eran pitched the product. "The combi tion of talent was really great," Doug P ladini, a member of the winning squ and Vans' vice-president for marketi told me afterwards.

I knew the best team had won, b after the votes had been tallied, wh McDonald asked me what I'd gotten of the experience, I couldn't stop mys from shoehorning in a pitch for h good our idea was, even if our presen tion wasn't tops. This was a competiti after all, and I was surprisingly sad team lost. ■

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BIANCO A reputation for scientific ingenuity—and grandiose claims

Is Cell Therapeutics In Remission?

The battered biotech's controversial CEO has won over Novartis, but investors are wary

BY ARLENE WEINTRAUB

ON A TENSE AUGUST day in 2005, Cell Therapeutics' chief executive sat in a conference room while the company's board of directors met next door and debated whether or not to fire him. The Seattle biotech's lead drug candidate, a lung cancer treatment called Xyotax, had failed a key clinical trial. To make matters worse, the CEO, Dr. James A. Bianco, had decided to sell off Cell Therapeutics Inc.'s only moneymaking drug. Throughout that gut-wrenching day, he was introspective but resolute. "I didn't question my vision and values," says Bianco, an oncologist who left clinical practice 15 years ago to develop cancer treatments that would be less punishing than chemotherapy and radiation.

Bianco survived the coup attempt and has been struggling ever since to regain his stride. Some days are pretty good. This year he persuaded the U.S. Food & Drug Administration to consider Xyotax as a drug just for treating women. Several studies, including four released on Nov. 8, show that Xyotax interacts with the female hormone estrogen to slow the growth of some tumors. If it's approved, Xyotax—a reengineered form of the chemo drug paclitaxel—could usher in a new treatment paradigm. The approval would bolster the idea that certain tumors behave differently in men and in women and give doctors a new weapon in the fight.

DOGGED BY SHORT SELLERS

FDA APPROVAL WOULD be a victory for Bianco, a controversial character whose reputation for scientific ingenuity is offset at times by his excessive enthusiasm. For example, Bianco estimates that Xyotax could be worth $500 million a year, and he even won the confidence of Novartis, which signed a co-development deal that could bring $285 million in much needed capital to CTI. But Bianco has a long history of making similar grand claims for the drug. Xyotax is still years away from the market—and short sellers who bet on CTI's continuing disappointments have made a killing.

Bianco hasn't shaken the black cloud that has hovered over him since he co-founded CTI in 1992. Xyotax, which was initially tested in both men and women, logged so many research disappointments that investors pounded the stock from 70 in 2000 to a recent 1.50. Clearly, the market is wary of Bianco's perennially sunny predictions. "He's not everybody's favorite CEO," notes CTI Chairman Phillip M. Nudelman. Even the Novartis milestone seems to have set pessimists sniffing for blood. Short interest in CTI's stock jumped 44% from August to September. Bianco is unlikely to regain investors' confidence until the FDA weighs in on the lung cancer approval in 2008.

Nonetheless, when the board considered who might make a worthy successor to Bianco, they couldn't think of anyone who matched his prowess in both medicine and finance, Nudelman says. Bianco has engineered 20 financing rounds, raising a cumulative $1 billion for CTI—a feat he lists on his résumé alongside his medical training and his penchant for collecting electric guitars and 16th century ceramics. "He always has more than one ball in the air," says George Bickerstaff, managing director of CRT Capital Group, a Stamford (Conn.) investment bank that has worked with CTI. "He's extraordinarily flexible in dealing with almost insurmountable challenges."

Bianco's toughest decisions were rooted in two acquisitions. In 2000, CTI bought a New York biotech and succeeded in getting its leukemia drug on

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the market. But by 2005 the product was generating just $22 million a year in sales while costing CTI $53 million a year. The company needed cash to support trials of Xyotax and another cancer drug, Pixantrone, which it picked up in its 2004 acquisition of Italian biotech Novuspharma. So Bianco sold the leukemia drug for $68.8 million and announced plans to cut staff in the U.S. and Italy by more than half. For the dissenting board members, recalls Bianco, "it was very emotional that I had the chutzpah to take this company back to a development-stage organization." (The four dissenters have left the company. Three didn't return calls; the fourth declined to comment.)

CTI has dodged so many bullets on Wall Street that it seems miraculous the company is still standing. Once, one of the physicians managing a trial of Xyotax was asked to participate in a conference call for investors, most of whom managed hedge funds. The call was supposed to be about two other cancer drugs, but the analyst threw in a question about Xyotax. The physician answered by expressing concern that some of the clinical trials were being done in Eastern Europe. "Boom! Our stock went down," Bianco recalls. More recently, investors blanched when NASDAQ threatened to delist CTI's shares. Regulators told Bianco that CTI's stock offering in September violated NASD rules. So he quickly bought back $3 million in shares and warrants from investors and escaped delisting.

Just when Bianco thought it was safe to crow about Xyotax again, more trouble arrived. On Nov. 3 the company announced it was suspending enrollment in Xyotax trials for six months so it could analyze patient mortality patterns. CTI also redesigned the study to focus on women with normal estrogen levels, including post-menopausal women who take hormone supplements. The changes were made based on guidance from the FDA. While the company does not believe the deaths signal safety issues, the suspension will push potential approval back by as much as six months.

Meanwhile, competitors have beaten Bianco to his goal of developing less toxic chemo drugs. An archrival, Los Angeles-based Abraxis Oncology, had reengineered paclitaxel approved to tr breast cancer in 2005.

Bianco rarely gets rattled—a ti he honed while attending Mount Si School of Medicine in New York. Wh still in his third year, the faculty invi him to be chief resident. "He was v thorough and compulsive, which qualities that made for an excellent r model," recalls Dr. Richard M. Stein, w directed the residency program at time. Bianco put himself through coll by managing three discount retail dr stores, so the administrative part of job didn't faze him. His biggest challe was soothing the psyches of reside who cracked under pressure. Diagnos disease, Bianco says, "is about learn to connect the dots real fast. I loved counseled them on how to get there."

Bianco hopes Cell Therapeutics is fi ly entering the last leg of its excrucia Xyotax marathon. Initial trials show 40% of women on the drug survive f year, vs. 25% of patients in control gro And the Xyotax patients suffer fewer effects, such as hair loss and anemia. C other lead drug, Pixantrone, whicl designed to be a safer version of a ch treatment that causes heart trouble, proven so promising in trials that Nov optioned the rights to develop it as we

CTI isn't out of the woods, yet Bia permits himself to feel vindicated least on good days. ■

BIO

James A. Bianco, MD

Inspired by his patients, he set out to mak gentler cancer drugs

BORN July 26, 1956, Bronx, N.Y., into an extended Italian American family.

EDUCATION BS, New York University, 1979; MD, Mount Sinai School of Medicine, 1983.

ARTS AND SCIENCE Father bought him an electric guitar when he was accepted to Bronx High School of Science.

FIRST MANAGERIAL JOB Put himself through college by running three branches of a drugstore chain.

FAVORITE PATIENT Successfully treated tenor José Carreras for leukemia at the Fred Hutchinson Cancer Research Center in Seattle.

FAMILY Married with three sons.

HOW HE UNWINDS Cooks, plays guitar, and collects win and 16th and 17th century art and ceramics.

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AM ASTON

NNOVATIONS

f corn biodiesel nd just a spritz f ethanol

VeraSun Energy has oked up a novel way get more fuel out of a shel of corn: It plans to tract both ethanol and odiesel from each kernel. e biodiesel comes from ried distillers grain," the otein-rich matter that is t over after corn is distilled o ethanol. Typically, DDGs e sold as animal feed. But ice they contain about % oil, VeraSun plans to e chemicals to extract d convert it to biodiesel fore selling the leftovers a lower-fat, higher-protein edstock. For every 100 llons of ethanol, VeraSun ys its process can harvest out 8 gallons of biodiesel.

Just a spritz, rather than losh, of ethanol could liver major mileage gains. ssachusetts Institute of chnology scientists have und that a mist of ethanol rayed directly into a hot linder can boost engine rformance by up to 30%— en using regular, non- anol-enriched gasoline. In lay's fuel, ethanol is mixed at concentrations of about % and sometimes up to %. MIT's trick is to spray e ethanol in tiny computer- ntrolled doses. Injected just the right time, the anol prevents efficiency- bing engine "knock" and lps the motor do more rk with each gallon of s. The necessary engine odifications would cost out $1,000 per vehicle, e MIT team estimates. eir startup, Ethanol osting Systems, is working h Ford Motor to market e technology.

GLOBAL WARMING

SPREADING LIKE WILDFIRE

EVEN BEFORE FIVE firemen were killed by fast-moving flames in California last month, it was a record year for wildfires. About 9.5 million acres of forest and grassland have gone up in 2006, a rate that's on track to double the recent annual average of 5.3 million. From the West to Texas to Florida, fires are bigger, longer, and more numerous than in any year since 1960, when records begin.

The grim trend is in line with findings published in *Science* last July, when the fire season was still young. Using data since 1970, a multi-institution team found that fire activity leapt suddenly in 1987, as plant and soil moisture levels began to fall below a critical threshold earlier each year.

The scientists contend that climate change, rather than forest management, is the culprit. Earlier springs, along with hotter, drier summers, are transforming moist plants from fire barriers into fuel.

SURGERY

NICE STUNT FOR A STENT: IT DISAPPEARS

FOR YEARS SURGEONS have used biodegradable sutures made of polylactic acid to patch up patients. Now this material may improve the performance of stents used to prop open clogged arteries. Today's metal-mesh stents can lead to scarring in blood vessels. More advanced, drug-coated versions prevent this but can result in blood clots months or years later.

The bioabsorbable stent, developed by Abbott Laboratories, may reduce these risks. It's rigid enough to widen an artery, but begins to dissolve after 12 months. By that point the vessel has reshaped itself and can stay open without a prop, says Dr. John Ormiston of the Auckland City Hospital in New Zealand, who performed the first experimental implants on humans. Within three years, the stent is fully absorbed. Fresh clinical data on the stents are due next March. *–Michael Arndt*

INFECTION

CLEANER TISSUE FOR TRANSPLANTS

EACH YEAR thousands of patients undergoing hip and knee surgery receive implants of bone, tendon, or ligament taken from deceased donor patients. Doctors first disinfect these tissues, but in rare cases they can still transmit serious infections, including hepatitis and HIV.

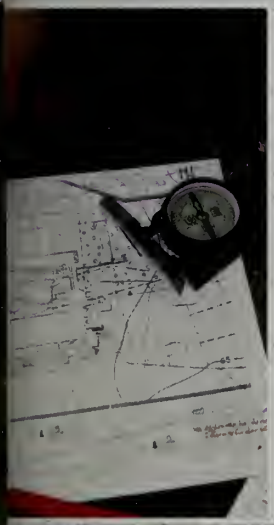
NovaSterilis has a novel technique for sterilizing donated tissue that kills all common pathogens but leaves helpful cells intact. They expose the bone or tendon to carbon dioxide that has been compressed

into a "supercritical" state, meaning it has properties both of a liquid and a gas.

Supercritical carbon dioxide has been used for years to sterilize food products. Scientists at Cornell University decided to apply it to living tissue and licensed key technology from Dr. Robert S. Langer at Massachusetts Institute of Technology. Not only does the technique kill off all the microbes, but in mouse experiments, bone that has been sterilized and transplanted back into the animals seems to promote new bone growth that signals acceptance, reports Cornell chemistry professor Bruce Ganem, an adviser to NovaSterilis. The company has begun to sell its system to tissue banks, which supply biomaterials to hospitals. *–Neil Gross*

Secret Agent Man

For a weekend of code-hunting, radio contact with Moneypenny, and unre



Licensed to Pretend
Our man in Germany, "Agent 001," Jack Ewing, faced enemy paintball fire and a swervy hovercraft ride as he crisscrossed an abandoned air force base in Eastern Germany. His mission: gather the codes he would need to crack a safe containing the secret information that would save humanity from the evil plans of arch-villain Minory. At no point did he parachute from a plane, although that was an option during his "Agent Training" weekend

Getaway

er," call your travel agent. **BY JACK EWING**

Q IS WAITING FOR ME as I warily push open the rusty door of the abandoned hangar. I take a seat at a table loaded with spy gear, and he gets right to the point.

"The situation is damned serious," he says. Of course. In my line of work the situation is always damned serious.

An onlooker might mistake me for a testosterone-challenged middle-aged man living out an adolescent secret agent fantasy. True, I am paying Munich adventure travel agency Mydays to take part in its "Agent Training" weekend on a former Soviet air base, a vast Cold War ghost town 40 miles north of Berlin. But that's just a cover. Q soon explains the real reason I, Agent 001, am here. "Your job," he says, pausing for effect, "is to save the world." Needless to say, he has brought along a bunch of cool weapons and vehicles that I'll need to do it.

RENDEZVOUS IN THE MIST

THE INTRIGUE actually begins the night before. As I pull up to the Hotel Döllnsee-Schorfheide in my rented Volkswagen Golf (Hertz was out of Aston-Martins), I am keenly aware that the former hunting lodge used to belong to the East German secret police. Now it's a wellness hotel located near the old base where Mydays stages a loose reenactment of the James Bond adventure *Casino Royale* (the new film version of which premieres in London on Nov. 14). Still, I check my room for listening devices, two-way mirrors, and Russian seductresses sent to entice and then blackmail me. Negative. I am asleep by 10.

This morning a cold mist hangs in the air as I rendezvous with Q. Soon we are zooming along deserted forest roads in his

(PAINTBALL GUN) COURTESY BENJAMIN PRITZKULEIT; (PARACHUTE) COURTESY MYDAYS; (BOTTOM LEFT) COURTESY NILS RODEKAMP; ALL OTHER PHOTOGRAPHS BY SEAN GALLUP/GETTY IMAGES

LOCKED AND LOADED
Ewing cuts a somewhat imposing figure, weapon at the ready. He celebrated saving the world with a martini

Vacation Royale

Booking: Munich-based Mydays stages the agent weekends roughly once a month, depending on demand. The events are normally held in German but Mydays can accommodate English speakers if there are enough participants. The company also books hundreds of other "experiences," ranging from a $16,000 upper-atmosphere flight in a Russian MIG 25 to a $57 course in brewing your own beer. For information, e-mail kundenservice@mydays.de or call 011 49 700 00693297.

Lodging: The Hotel Döllnsee-Schorfheide, a former East German government guest house near the village of Gross Dölln about 40 miles north of Berlin, offers singles for $135 including an ample breakfast. The pleasantly renovated hotel, a short drive from the Mydays agent training site, has an indoor pool as well as swimming in the nearby lake during the summer. (Phone 011 49 39882-630, fax 49 39882-63402, or visit info@doellnsee.de.)

black Mercedes, 007 theme music blaring. My job is to find secret codes that the villain Minory, who is bent on destroying the world but has trouble recalling numbers, has hidden around the base. The codes will open a safe containing the secrets that will save humankind. Q drops me at a swamp. As I pull on a ski mask and zip up my black jumpsuit, I remember his chilling words from earlier: "I won't be surprised if you don't make it back here tonight."

I climb aboard a waiting hovercraft. (Bond always has a hovercraft waiting.) "You must be Felix Leiter," I say to the pilot, referring to the ever-helpful CIA agent. "Something like that," he replies, cautioning me to keep my muddy boots off the side of his craft. As we ricochet against sandbanks and swerve sideways across the water, I discover that riding in a hovercraft is like being the puck in a game of air hockey. Through the binoculars slamming against my forehead, I note a first code number spray-painted on a yellow placard. I call Miss Moneypenny, British spy chief M's assiduous secretary, on my portable radio. "Agent 001 reporting. First code found," I say. Her soothing voice penetrates the static. "Understood," she replies.

SNIPERS AND SWEAT

BUT I STILL HAVE a long way to go. Luckily, Q has given me a compass, a plastic map I can hang around my neck, and a pocket-size booklet with detailed directions. Very detailed. In fact, Q must think Bond is getting senile. The directions say things like: "At the end of the runway, follow the sandy path along the fence until the WHITE GATE." In case that's unclear, there's a photo of the WHITE GATE.

I move cat-like along a wooded path. Suddenly I hear shots. Projectiles whiz from nearby trees. I'm hit! But the paintball bounces off harmlessly without burst-

ing. I'm bulletproof—just like B
I return fire with my semiauton
paintball gun, retreating to a
where Q has stashed a Jungle
er, a combo mountain bike, ch
scooter, and lawn mower. I'm
sure Bond would ride one of t
but never mind. I zoom off pas
snipers in search of the next co

Over the next few hours, I criss
what was once the largest air ba
the Warsaw Pact. On foot, I slink
fortified hangars that housed
fighters and hike over territory
scarred by tank treads. I don a
mask and search a smoke-filled tu
that once concealed an SS-20 m
nuclear missile. As my flashlight
the darkness, I think, "Man, those
sian missiles were pretty long. Good t
they're not pointed at us anymore."

Later, I kick-start an off-road
torcycle that Q has hidden and vag
marked on my map. I steer thro
stands of pine and around piles of
Army garbage. Bathed in sweat, h
pumping, I scramble over an emb
ment on my belly to avoid a sniper hi
in trees. As I near my goal, I spot a g
of men parking cars next to the run
Enemy agents waiting to shanghai n
the Bahamas? No. They have somet
to do with a Mercedes marketing e
The men seem strangely blasé a
seeing an armed guy in a black ski m
talking on a radio.

Finally, amid a hail of paintballs
Myday's paid assassins, I dash into
"casino"—an abandoned building—
punch the codes I've collected into a
It buzzes and opens, revealing an enve
containing a map of the base. I've res
humanity. I've also had a blast. The w
end costs $470, not including hote
$700 if you parachute into enemy terri
(I didn't, on the theory that I'll risk m
for the Queen, but not for a travel stor

Outside the casino, Moneypenny h
open the door of a Mercedes. "Congra
tions on saving the world, 001," she p
Back at the base, she hands me a cigar
a martini. Shaken, not stirred. ■

BusinessWeek online I was a member of Her Majesty's Secret Service—for a day. Go to businessweek.com/extras.

For a look at guys-only getaways, watch BusinessWeek Weekend. Check TV

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White truffles, cèpes, and garlic at Aujourd'hui

Underground Treasure

Through mid-December, rare, pricey white truffles from the Piedmont region of Italy are casting their spell. **BY AMY CORTESE**

ONE DAY IN MID-October, the kitchen staff at Spiaggia, a four-star Italian restaurant in Chicago, was preparing for the day ahead when the cry went out: The delivery is here! A small crowd gathered in the kitchen as a painstakingly wrapped airmail package was opened, releasing a distinctively pungent aroma into the air. *"Che bel' profumo!"* exclaimed one staffer. The season's first shipment of white truffles had arrived.

Similar scenes have played out in restaurants across the country since the start of the white truffle season, which runs from mid-October through mid-December. Few things are as eagerly anticipated by chefs and gourmands, or inspire such rhapsodic transports, as the *Tuber Magnatum*, the official name for this mushroom kin that grows underground, mainly among the roots of particular trees, such as oak and poplar. The white truffle has been called the Mozart of mushrooms and is said to contain pheromones, which contribute to its powerful scent and reputation as an aphrodisiac.

The truffle has always had a mystique. And at a time when high-end restaurant kitchens are acting a lot like chemistry labs (BW—Sept. 11), the truffle is decidedly Old World. It remains stubbornly resistant to cultivation, growing only in areas favored with a particular comb tion of soil, moisture, and trees—in p ticular, the Piedmont region of north Italy. With limited supply and clan ing world demand, truffle hunting become a furtive affair. Hunters, ai by specially trained dogs that can s out the subterranean delicacies, fan into the woods under cover of nigh avoid giving away their choice spots. good-sized truffle—golf-ball-size or l er—can fetch a small fortune. Prices year are as much as $2,500 a pound, last year, a rare 2.6 pound white tr commanded a record 95,000 euros $121,000, at a charity auction in Italy

The flavor of the white truffle is not ously hard to describe. Nothing in

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FUNDAMENTAL STRENGTH – CAPITAL AND PEOPLE

AFTER AND BEFORE Over carpaccio at Bottega del Vino and fresh off the plane at Spiaggia

vocabulary quite invokes its unique combination of nutty, musky earthiness and vanilla- and floral-noted delicacy. "Parmigiano, garlic, the sweetness of white button mushrooms, chestnuts. It's a little like asking: 'What color is red?'" says Alessandro Stratta, chef at Alex at the Wynn Las Vegas, who grew up in Piedmont.

"THE PLAINER, THE BETTER"

IF ALL THIS SEEMS like an awful lot of fuss over a fungus, you haven't tried one. At a recent lunch at Bottega del Vino, a New York outpost of the storied restaurant in Verona, Italy, the white truffle's charms are on full display. A waiter arrives with a course of baby pumpkins filled with fonduta, a soft fondue-style cheese, and porcini mushroom. Accompanying him is chef Massimiliano Convertini, who proudly displays what looks like a small, knobby potato with an intricate pattern of veins. He begins slicing the knob with a mandoline. Tawny snowflakes float down, and an intense, almost intoxicating fragrance spreads through the room. Nearby diners put down their forks and stare.

The pumpkin dish is sheer bliss, the truffle punctuating the creamy cheese and sweet pumpkin flesh. On beef carpaccio, a generous sprinkling of truffle transforms a standard dish into a sensual delight, while showered onto risotto it melts into a mellow, buttery harmony.

When it comes to truffles, the best approach is to choose simple, neutral-flavored bases that enhance but don't overwhelm—think risotto, pasta, or even scrambled eggs. "The plainer, the b ter," says Tony Mantuano, chef and owner of Spiaggia, who plans to get th pounds of the tubers flown in every w through the end of the season. "' spend so much money on them, you do want to cover them up." Unlike the bl truffle, tartufo bianco isn't cooked eaten raw, usually thinly shaved or gra (Tip: Avoid grocery store truffle oils. T are usually artificially flavored.)

Many restaurants will suggest dis on their menus to which truffles can added for a supplemental fee, typic $6 to $10 a gram. T can quickly add up a modest five- or gram serving—enou to cover the food. the best way to sam the full potential of truffle is to indulge one of the many spe tasting menus offe by restaurants in vember, when tartufi at their best and m abundant (table). will cost you—anywh from $150 to $1,000 more a person. W pairings may be ad at an extra cost. renowned Barolo m in Piedmont is a nice companion.

Despite the lofty prices, chefs in they aren't making much of a pr and possibly even lose money. Trut must be flown in and served prom since they lose their pungency the lon they're out of the ground. And some cl admit to a heavy hand with the sli "You've got to indulge," says chef Stra "People who know what white tru are don't even blink at the price." ■

Where to Indulge When You're on the Road

BOSTON
Aujourd'hui
617 351-2037

Four-course white truffle menu includes cèpe tart with garlic puree, hand-rolled garganelli, roasted pheasant, and truffle-laced ice cream, $265 per person

CHICAGO
Spiaggia
312 280-2750

Five-course tasting menu includes Barolo-braised veal with creamy yellow polenta and ricotta fritters with truffled honey, $195 a person (or a $70 supplement for truffle shavings on selected dishes)

LAS VEGAS
Alex
888 320-7110

Six-course truffle menu includes parmesan-and-bone-marrow custard and roasted turbot with cauliflower puree and chestnuts, $500 per person

LOS ANGELES
Valentino
866 375-0674

The eight-course "Piemonte in Fall" menu includes "handkerchief" pasta with pesto of hazelnuts and white truffles, $175 per person

NEW YORK
Bottega del Vino
212 223-3028

San Domenico
212 265-5959

A la carte menu includes homemade, egg-yolk-filled ravioli with a truffle butter sauce and truffle shavings: $6 a gram (at least 5 to 6 grams are recommended)

RUTHERFORD, CALIF.
La Toque
707 963-9770

The five-course pri fixe ($98 a person) changes weekly. Recently it featured for $45 additional, ravioli with Caesar's Amanita (a Bulgaria mushroom) and shaved white truffle

ortin Eberhard's Life.

artin Eberhard's Life on a BlackBerry Pearl.

the new BlackBerry® Pearl™ smartphone, Martin Eberhard's day moves as fast is cars. At the test track, he uses the media player* to view a video of a new otype. Emails a financial update to a short list of Silicon Valley power investors. cks BlackBerry® Maps* for the nearest winding road. Hops in his own electric a Roadster, and drives fully charged into the future. With BlackBerry, life may ear larger. What will your life look like on the new BlackBerry Pearl? l out at www.blackberrypearl.com.

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BlackBerry Pearl

BY MIKE MARRONE

Soul, R&B, and The Heart of a Poet

I THOUGHT IT WOULD BE HARD to decide which artist to spotlight my first *BusinessWeek* column. But all I had to do was turn to my home stereo, where I've been playing Phil Roy's new CD *The Great Longing* virtually nonstop for a month. Roy has been toiling in relative obscurity for quite some time, writing songs bursting with passion, skill, and, most of all, soul. Quite possibly you've heard his music and didn't know it. He composed the title track for Ray Charles's 1993 album *My World* and has written songs recorded by Pops and Mavis Staples, Joe Cocker, Aaron Neville, and cult favorite L.A. Guns, among many others.

Drawing on his roots in Philly Sound soul and a devotion to the music of artists such as Marvin Gaye and Stevie Wonder, Roy unites R&B, straight-up soul, and a hint of jazz with the more confessional approach of a Jackson Browne or Elliott Smith. You can hear this clearly on the new album's track *Day To Day Thing*, which starts with a muted, jazzy trumpet and percolates with a rhythmic bottom that falls somewhere between hip hop, jazz, and funky soul. The Neville Brothers first recorded the song in 1992, but Phil has reclaimed it and changed a few of his original lyrics to reflect his frame of mind today: "I read the obituaries and I don't see my name, I thank the Lord I'm living and see what tomorrow will bring. It's a day-to-day thing." It may seem a bit bleak, but the song swings with optimism.

Over two years in the making, *The Great Longing* does not contain a single note out of place. Tracks like the funky New Orleans flavored *Exceptionally Ordinary* (a duet with acclaimed vocalist Madeleine Peyroux), introspective *Without Conscience*, and irresistible *Busy Thinkin' Bout Today* (with Philadelphia neighbor Amos Lee) radiate a tube amp analog warmth in our increasingly cold digital world. Point your Web browser to philroy.com and order an advance copy. Although he doesn't have a label yet for this album, Phil Roy can still put one out, and if you ask when you order it, he'll even sign a copy for you.

Bonus tracks from my playlist

DAMIEN RICE: This Irish singer/songwriter is on the verge of a major breakthrough, and his new album 9 (Warner Bros.) may be just the ticket. *Nine Crimes*, the initial single, builds from a quiet piano intro and beautiful whispered first verse from Lisa Hannigan who shares call-and-response vocals with Damien. *Elephant* opens with a lightly strummed acoustic guitar, then gradually picks up cello, more strings, and drums, ending a *cappella*.

LINDSEY BUCKINGHAM: *Under The Skin* (Reprise), his first solo effort in over a decade, finds the studio wizard taking charge of most of the instruments himself. Combining multitrack layers of his trademark guitar virtuosity with vocal harmonies inspired by Brian Wilson, Buckingham has crafted a challenging yet ultimately rewarding work. It contains an interesting cover of the obscure Mick Jagger/Keith Richards tune *I Am Waiting* and a deconstruction of Donovan's *To Try For The Sun*, but my picks are Buckingham originals *Show You How*, *Cast Away Dreams*, and *Down on Rodeo*.

Mike Marrone is program director of XM Satellite Radio's The Loft, a channel that focuses on an eclectic mix of singer-songwriters from the 1970s through the present.

Driven by performance

There are over 40 million two-wheelers sold every year, mainly in Asia. In five years time, annual production is expected to exceed 60 million. SKF's know-how is a driving force when it comes to making two-wheelers lighter, smarter, safer and more economical to run. Thanks to our innovative solutions engine life can be extended by 20% under extreme conditions.

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BY ROBERT PARKER

Penfolds is Fielding A Strong Team

THE MOST ACCLAIMED WINE from Down Under is Penfolds Grange. Made primarily from shiraz (as syrah is known in Australia), Grange can age for 30 to 40 years. Even though production is high for wine of this qualit it can be difficult to find because of heavy demand. However, Penfolds is much more than just Grange, and its newest portfolio, which may be the strongest I have tasted in the past decade, includes a few super values. Following are some current and up-and-coming releases.

2005 Riesling Reserve Bin
90 points. This crisp riesling exhibits notes of honeyed grapefruit, wet stones, rose petals, and figs. It should drink well for one to two years. $18

2003 Shiraz Bin 28 Kalimna
89 points. Showing the cooler climate side of this varietal, this cuvée has white pepper, mint, red and black currant, underbrush, and spicy characteristics. This medium-bodied but substantial shiraz can be enjoyed over the next four to five years. $22

2004 GSM Bin 138
91 points. This blend of 49% grenache, 40% shiraz, and 11% mourvèdre exhibits attractive sweet flower garden, kirsch, licorice, and chocolate characteristics. A medium- to full-bodied, lively, fleshy red that carries its 14.5% alcohol with precision and purity, it is an Australian version of a top French Côtes du Rhône that should drink well for five to six years. $25

2004 Shiraz/Cabernet Koonunga Hill
91 points. An outstanding blend of 62% shiraz and 38% cabernet sauvignon aged in old 300-liter hogsheads, this dense purple-hued wine exhibits scents of blackberries, truffles, old leather, licorice, and pepper. Heady ripeness, a fleshy mouthfeel, decent acidity, and a long finish suggest it should drink well for 10 to 12 years. $25

2004 Chardonnay Reserve Bin 04A
91 points. Bottled with a light filtration, it exhibits a big, smoky bouquet of hazelnuts, honeyed oranges, peaches, and apple blossoms. With good crispness, medium to full body, and a flamboyant, extroverted personality, it should be enjoyed for two to three years. $30

2003 Shiraz Magill Estate
94 points. A deep ruby/purple color is accompanied by a perfume of graphite, acacia flowers, and toasty oak. The wine hits the palate with a plethora of flavors, including chocolate, spice box, fruitcake, black raspberries, blueberries, and cassis. Powerful yet elegant, it should drink well for 15 or more years. $50

2003 Shiraz RWT
96 points. This powerful, complex, dark-purple-hued offering boasts blackberry, kirsch, mulberry, soy, and road tar aroma Full-bodied, dense, and rich with beautifu integrated oak, it is more evolved and for than the Magill or the Grange. Consume i now, or cellar it for 10 to 15-plus years. $7

2001 Grange
98+ points. One of the few vintages of this cuvée composed of 100% shiraz, 2001 Grange is undeniably one of the examples of this wine. Inky/blue/purp to the rim, with a stunning perfume of blueberries, blackberries, chocolate, graphite, and earth, it boasts good aci huge tannins, magnificent concentrati and a multilayered, textured mouthfee It is a big but impeccably well-balance shiraz that should shed some of its structure and tannin over the next fou five years and be at its best between 2 and 2030-plus. $225

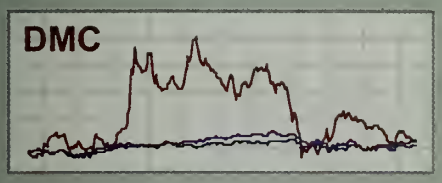
Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or tc order his recent book, *The World's Grea Wine Estates: A Modern Perspective.* Yc can also subscribe to Parker's newslett *The Wine Advocate.* Request a sample copy at: *The Wine Advocate,* P.O. Box 31 Monkton, MD 21111.

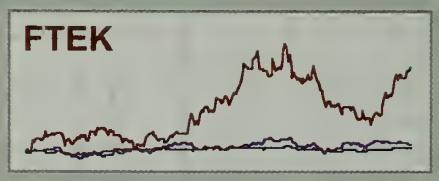
Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/e

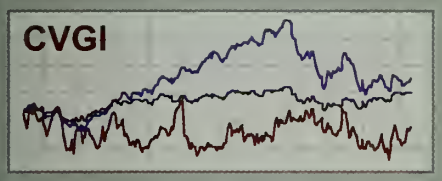
4 TOP COMPANIES: AVERAGE 59% GROWTH

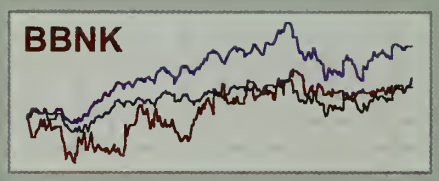
Equity Investor's Micro-Cap Review

e Micro-Cap companies featured on this page were among America's top domestically traded companies h market capitalizations from $20 million to $500 million, in terms of their most recently reported 12-month enue growth as of 8/31/06. While past performance is never a guarantee of future results, these four npanies represent investment opportunities worthy of any Micro-Cap investor's close consideration.









12-Month Price Performance for period ending 08/31/06 ● Stock ● Industry ● S&P500

Document Security Systems, Inc.

Symbol: DMC
Industry: Diversified Services (Sector: Security)
IR Contact: Deborah Pawlowski
dpawlowski@keiadvisors.com

Document Security Systems is a world leader in anti-counterfeiting and brand protection technologies which prevent unauthorized copying, scanning, and photo imaging. DSS's AuthentiGuard product suite can be printed traditionally, digitally, or delivered via the internet, on documents such as checks, coupons and vital records, consumer packaging, and ID cards.

- 12-MO REVENUE GROWTH: 63%
- MARKET CAPITALIZATION: $127 mil.
- 3 YR ANNUAL REVENUE GROWTH: 33%
- Q2 06 GROSS PROFIT MARGIN: 45.13%
- DEBT-TO-EQUITY RATIO: 3.55%

Fuel Tech, Inc.

Symbol: **FTEK**
Industry: Energy
IR Contact: Tracy H. Krumme
tkrumme@fueltechnv.com

Fuel Tech is engaged in the development of environmentally sustainable technologies designed to optimize processes and improve efficiencies in air pollution control and energy production. Using proprietary software, chemical injection strategies are formulated to treat the liquid/solid fuels combusted by utilities and industrial plants.

- 12-MO REVENUE GROWTH: 60%
- MARKET CAPITALIZATION: $360 mil.
- 12-MO PRE-TAX INCOME GROWTH: 169%
- LOW CAP EX & HIGH MARGINS
- CASH ON HAND: $26 mil.

Commercial Vehicle Group, Inc.

Symbol: **CVGI**
Industry: Manufacturing
IR Contact: Chad M. Utrup
Chad.Utrup@cvgrp.com

CVG designs and manufactures products for the global commercial vehicle market, including the heavy truck, construction, agriculture, military and specialty vehicle markets. The company strategy is based upon acquisitions, organic growth, global expansion and supply-base consolidation.

- 12-MO REVENUE GROWTH: 58.64%
- MARKET CAPITALIZATION: $415 mil.
- 12-MO EPS: $2.49
- Q2 2006 NET DEBT: $148.3 mil.
- 12-MO REVENUE: $870.1 mil.

Bridge Capital Holdings

Symbol: BBNK (Nasdaq)
Industry: Banking
IR Contact: Thomas A. Sa
ir@bridgebank.com

Bridge Capital Holdings is parent company of Bridge Bank, one of the fastest growing commercial banks in the Nation. Established in 2001, Bridge Bank's unique brand of business banking delivers superior financial solutions to small, middle-market, and emerging growth companies in Silicon Valley, California and the Nation.

- 12-MO REVENUE GROWTH: 52.73%
- MARKET CAPITALIZATION: $125.8 mil.
- 12-MO EPS GROWTH: 68%
- YTD (9 MO) RETURN ON EQUITY: 19.3%
- 5-YR CAGR OF TOTAL ASSETS: 71%

Quirkiest Vehicle On the Street

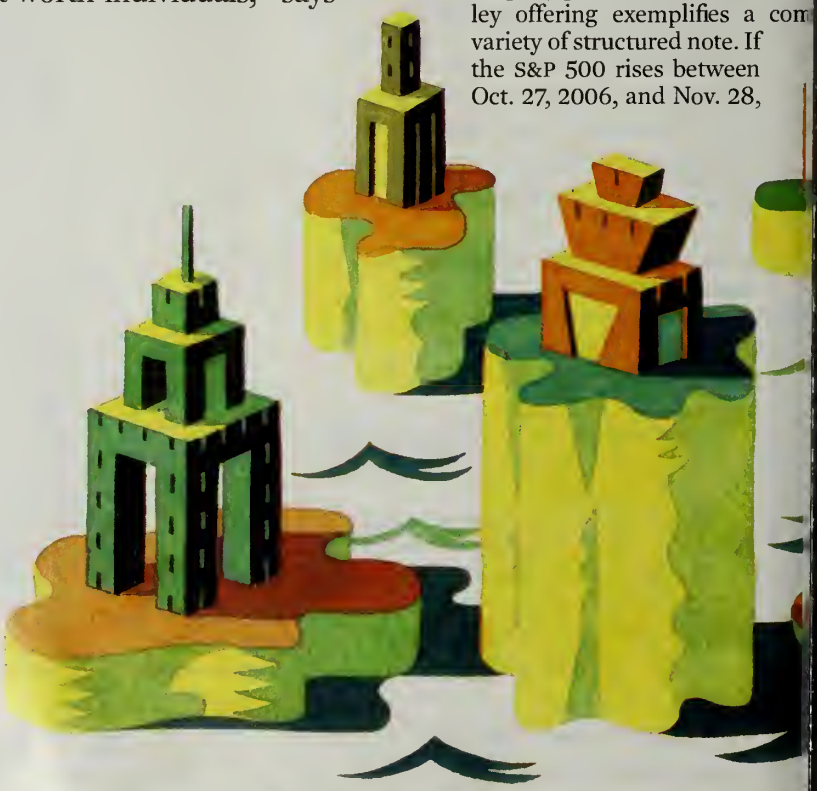
Structured notes can offer high yields and principal protection. But they come wit some serious drawbacks. **BY ANNE TERGESEN**

WITH THE GROWTH OF EXCHANGE-TRADED funds, hedge funds, and separate accounts, investors have all sorts of newfangled ways to pump up their portfolios. Now, many advisers are pushing yet another product: structured notes. ¶ Popular with individual investors in Europe and Asia, these option-based investments alter the risks and potential rewards of buying stocks, bonds, or other securities. Until recently, these notes have been used in the U.S. mainly by institutional investors. But hundreds of private banks, brokerage firms, and independent advisers are starting to sell them. The market: mainly "middle- to high-net-worth individuals," says Richard Mikaliunas, senior vice-president at the American Stock Exchange, which lists about 85% of the structured products that trade on exchanges. For $1,000 each, you can even buy a few structured notes on Fidelity Investments' Web site, Fidelity.com.

While structured notes can offer an assortment of attractions, from high yields to principal protection, this relatively undeveloped market has some serious downsides. Among them: sometimes opaque fees, poor liquidity, and a high degree of complexity. "I like some of them—provided the fees are low," says Janet Tavakoli, president of Tavakoli Structured Finance, a consulting firm specializing in derivatives. "But even many advisers are not able to deconstruct a note to determine if it is a good value."

Structured notes are not issued by corporations or government entities looking to raise money. Instead, financial institutions create them to fill an investment need and make a buck for themselves. The minimum invest is usually $1,000. They can be base stocks, bonds, commodities, or cu cies. Right now, the most popular s tured notes give investors exposure single stock or broad market index, as the Standard & Poor's 500-stock i or the Nikkei.

What distinguishes structured from straightforward stock or i funds is that they expire within a se riod—typically from 1 to 10 years. T also incorporate options to limit ris magnify gains. A recent Morgan ley offering exemplifies a com variety of structured note. If the S&P 500 rises between Oct. 27, 2006, and Nov. 28,



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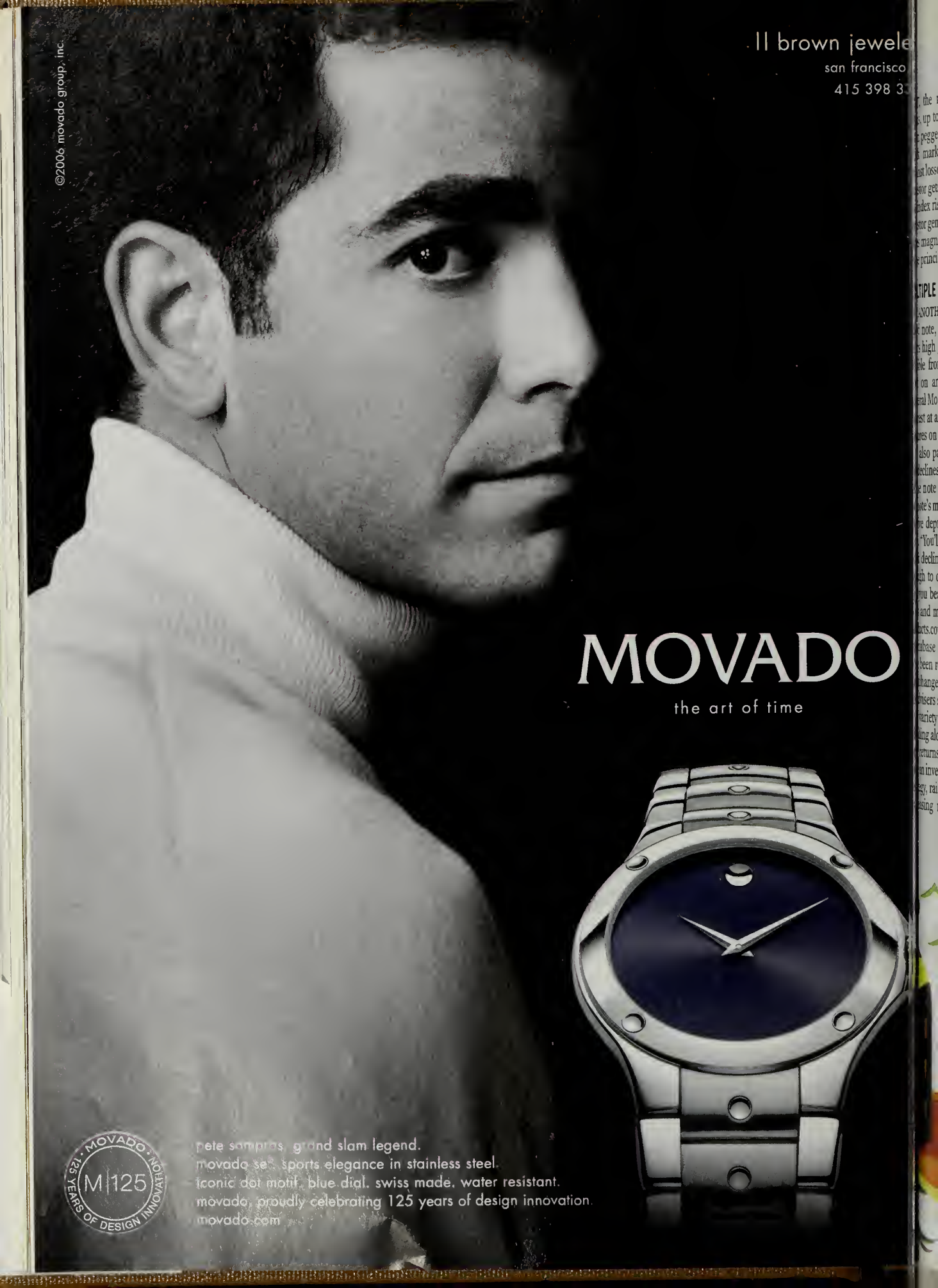
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iconic dot motif. blue dial. swiss made. water resistant.
movado, proudly celebrating 125 years of design innovation.
movado.com

; the note will deliver twice the s, up to 12%. Another type of note, pegged to the S&P 500 or another market index, offers protection st losses. When the note expires, the tor gets the principal back, whether ndex rises or falls. But if it rises, the tor generally gets some gains. Other s magnify gains, often at the cost of principal protection.

TIPLE USES

ANOTHER POPULAR breed of struc- l note, called a reverse convertible, s high yields. A recent reverse con- ble from Barclays, for example, is on an underlying investment in ral Motors shares. The note will pay est at an annual rate of 16% when it res on Feb. 8 of next year. The note also pay back the principal. But if leclines by 20% or more over the life e note and returns are negative by ote's maturity date, the investor will ve depressed GM shares instead of "You'll get a nice coupon, but if the declines, that income may not be gh to offset your losses. That's the ou bear," says Joe Burris, head of and marketing at structuredretail- ucts.com, a Web site that maintains tabase of structured products that been registered with the Securities change Commission.

visers say they use structured notes variety of ways. When a market is ling along, a leveraged note can am- returns. Notes can also fine- an investor's asset allocation egy, raising returns without asing risk. Rhian Horgan, global head of equity derivatives at JPMorgan Private Bank, says that by buying a note with some downside protection on, say, the S&P 500, an investor may be able to increase exposure to riskier assets with higher expected returns, such as private equity, without raising overall risk.

The notes' fees can be high, and liquidity can be poor

Protection may come at a steep price. When you buy a structured note, you'll pay your bank or brokerage firm as much as 1.5% to 2% of your total investment for a one-year note. That's built into the price. Fees may be even higher for notes with longer maturities, says Tavakoli. The cost of a note also includes some amount—often 0.5% to 1%—that goes to the investment bank that issued the note, she says. While the prospectus will spell out the distributor's fees, it may not disclose the investment bank's. And if you work with a broker, you may pay yet another commission.

The fees are levied up front. When amortized over the life of a note, "in some instances, they are less than those on comparable mutual funds," says Philippe El-Asmar, managing director at Barclays Capital, a big issuer of structured notes. If you buy a principal-protected note for $1,000, the fees won't cause you to get back less than the $1,000 you put down, as long as you hold the note to maturity, Tavakoli says. But they may reduce the leverage you'll get via the options market. For example, a note with high fees might promise to pay only 1.5 times the gains of the S&P 500, vs. two times for a comparable but cheaper alternative, she adds.

Liquidity is another concern. If you want to sell a structured note before it matures, your broker or bank will most likely buy it back. But there are no guarantees. Moreover, as with other thinly traded securities, the spread between the purchase and sale prices that dealers quote can be wide, with the norm around 1%.

Conflicts of interest may also put investors at a disadvantage. Because the U.S. structured note market is young, private banks and brokerage firms still often favor notes produced by affiliated investment banks. The worry, of course, is that they may not always procure the best deals.

TAX THICKET

THE FEATURES and terms of these notes can be complicated, too. For example, if you sell a principal-protected note before it matures, you're no longer entitled to principal protection. Instead, you'll receive the market value of your note, which may be greater or less than what you paid. Investors in these notes don't typically receive dividends.

The tax treatment varies. Notes that fully protect principal are generally treated like bonds and are subject to income-tax rates of up to 35%. In contrast, profits on notes with no downside protection are taxed at capital-gains rates of up to 15%, provided you hold them for at least a year. But the tax treatment of notes that offer some, but not full, principal protection isn't always clear.

Investors don't have to meet any net worth or income requirements to buy structured notes. But the National Association of Securities Dealers has urged member firms to sell structured notes only to sophisticated investors. All others should stick with simpler but more transparent investments. ■

RICHARD BEARDS

BY GENE G. MARCIAL

THE JET INDUSTRY BOOM AND BUYOUT TALK FLOAT GOODRICH.

HOVNANIAN: A FIXER-UPPER—BY NO MEANS A TEAR-DOWN.

CHINESE ENERGY IS RED-HOT, AND PETROCHINA LEADS THE PACI

A Goodrich Joyride

WITH AIRLINES REBOUNDING and plane orders, especially at Boeing, winging up, Goodrich (GR) is airborne. A maker of jet-engine and other aircraft parts, such as airframe and electronic systems, "Goodrich has the strongest growth profile in aerospace," says Jeffrey Kleintop at PNC Wealth Management, which owns shares. Demand is driven by growth of fleets of planes with more than 100 seats. He says many observers thought last year's level of 1,000 jetliner orders couldn't be sustained, "but we have seen orders exceeding 1,000 so far in 2006." The surge will continue, he believes, as airlines upgrade with more fuel-efficient planes. And more airlines are emerging in Asia, where traffic is growing fast, says Kleintop. Richard Tortoriello of Standard & Poor's has raised Goodrich from a "hold" to a "buy" and upped his 2006 earnings forecast (excluding a $1.15 tax gain) by 15¢, to $2.55 a share, and his 2007 estimate by 15¢, to $3.05. "With fleets growing and air travel strong, we expect good demand for Goodrich's parts and its maintenance, repair, and overhaul services to continue for at least the next two years," says Tortoriello. Goodrich's stock has flown from 37 in mid-June to 44.72 on Nov. 8. PNC's Kleintop says one more factor will lift the stock: a possible buyout. The scuttlebutt, he says, is that rivals Honeywell International and United Technologies, as well as General Electric, which has a jet engine unit, are eyeballing Goodrich. He thinks the stock could hit 55 in a year, but in a deal, he figures it's worth 60. Honeywell, United Technologies, and GE declined comment.

Hovnanian May Get Its House in Order Fast

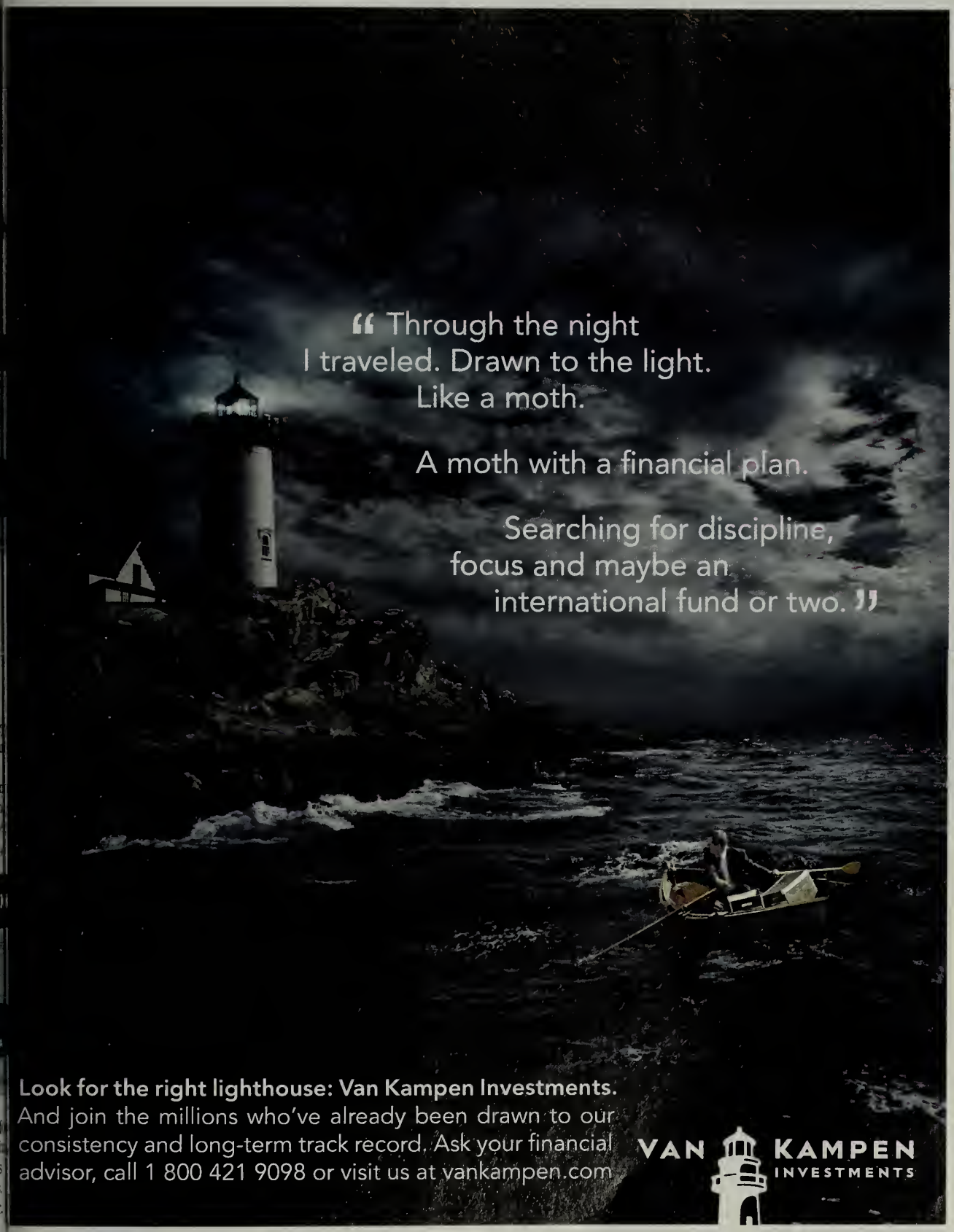
HOVNANIAN ENTERPRISES (HOV), like other homebuilders, has suffered a big drop in orders. But it is one stock that a few contrarians and daring bargain hunters are betting on for a recovery sooner than the rest of the pack. Its stock has crashed from 54 in January to 25 in August and has since edged up to 28.35. The company posted a 34% drop in earnings for its latest quarter, but it did not cut its estimates of $5 to $5.75 a share for 2006. The consensus for 2007 is $3.18. Has the shattered stock already more than discounted the housing bust? "The upside potential significantly exceeds the downside risk," says Bernie Schaeffer, CEO of Schaeffer's Investment Research, which has bought shares. He sees the stock at 50 in a year. Ivan Feinseth of Matrix USA adds: "Hovnanian is priced like it's going out of business." Orders have only slowed but haven't stopped, says Feinseth, who rates the stock a "strong buy."

PetroChina Is Energy's 800-Pound Panda

WITH CHINA the world's second-largest user of energy, some Street pros are putting their mone PetroChina (PTR), China's top oil and gas produ as a play on what they see as a long-term bull market on energy. With China and India growing so fast, global dem for energy can only surge, and PetroChina is sure to be th top beneficiary, with its dominance in all aspects of Chine energy, says Frank Holmes, CEO of U.S. Global Investors, which owns shares. PetroChina, which trades on the Big Board, is 88% owned by China National Petroleum, China's No. 1 energy organization. Holmes says the stock remains cheap. And he also likes PetroChina's 4.5% dividend yield. Morningstar, in a report, says that, with China's protective rule, the downside for PetroChina is limited: It won't suffer if oil prices fall. China's huge gas reserves and extensive pipeline, it adds, put PetroChina in "an excellent position to benefit from China's plans to expand the use of natural gas as a fuel fc power plants." S&P says it remains positive on PetroChin given China's "robust demand for oil" and PetroChina's improving refining margins and continued acquisitions. S&P's target for the stock, now at 114.54, is 128 in a year.

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor tl firms hold positions in the stocks under discussion. Similarly, they have no investr banking or other financial relationships with them.



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OCKS

IMENTARY

stors responded positively e Democrat's big gains is year's congressional ions. The Dow established her new record high on 8. Energy stocks were hot, ted in part by California 's' rejection of a ballot sure for an oil tax. PMC- a jumped 15.6% for the .. The semiconductor pany rolled out a new chip.

loomberg Financial Markets, Reuters

U.S. MARKETS

	NOV. 8	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1385.7	1.3	11.0	13.7
Dow Jones Industrials	12,176.5	1.2	13.6	15.5
NASDAQ Composite	2384.9	2.2	8.1	9.8
S&P MidCap 400	791.6	2.1	7.3	11.4
S&P SmallCap 600	392.4	2.2	11.9	14.1
DJ Wilshire 5000	13,876.5	1.5	11.0	14.0

SECTORS

BusinessWeek 50*	778.3	1.0	4.9	5.6
BW Info Tech 100**	431.1	0.6	13.3	16.8
S&P/Citigroup Growth	642.8	1.3	7.8	10.1
S&P/Citigroup Value	740.8	1.3	14.4	17.5
S&P Energy	443.6	4.1	19.0	20.2
S&P Financials	478.9	1.4	12.3	16.1
S&P REIT	187.0	-3.0	22.2	27.9
S&P Transportation	270.9	1.8	8.4	14.3
S&P Utilities	180.5	-1.3	13.1	15.7
GSTI Internet	195.6	4.2	-4.7	1.1
PSE Technology	865.0	2.0	3.4	6.0

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	NOV. 8	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1891.3	1.5	25.1	33.4
London (FT-SE 100)	6239.0	1.5	11.0	14.2
Paris (CAC 40)	5437.2	1.2	15.3	20.7
Frankfurt (DAX)	6349.3	0.9	17.4	26.8
Tokyo (NIKKEI 225)	16,215.7	-1.0	0.6	15.5
Hong Kong (Hang Seng)	18,811.2	1.9	26.4	30.6
Toronto (S&P/TSX Composite)	12,378.2	2.7	9.8	16.6
Mexico City (IPC)	23,930.6	3.9	34.4	50.2

FUNDAMENTALS

	NOV. 7	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.78%	1.78%	2.06%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.5	17.5	17.9
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	14.9	14.5
First Call Earnings Revision*	-2.22%	-2.57%	-1.51%

*First Call Corp.

TECHNICAL INDICATORS

	NOV. 7	WEEK AGO	YEAR AGO
S&P 500 200-day average	1295.6	1293.9	Positive
Stocks above 200-day average	67.0%	68.0%	Neutral
Options: Put/call ratio	0.85	0.82	Positive
Insiders: Vickers NYSE Sell/buy ratio	4.42	4.31	Negative

BEST-PERFORMING GROUPS

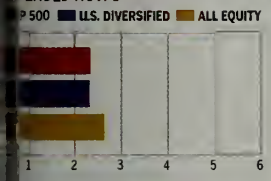
	LAST MONTH %		LAST 12 MONTHS %
Internet Retailers	21.0	Steel	94.7
Consumer Electronics	20.5	Agricultural Products	50.4
Photographic Products	18.8	Divsfd. Metals & Mining	49.6
Real Estate Mgt. & Dvpt.	17.0	Fertilizers & Ag. Chems.	42.7
IT Consulting	16.0	Intgrd. Telecmms. Svcs.	41.2

WORST-PERFORMING GROUPS

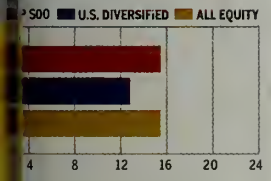
	LAST MONTH %		LAST 12 MONTHS %
Education Services	-30.8	Education Services	-46.8
Airlines	-8.7	Homebuilding	-25.1
Health-Care Services	-8.7	Internet Software	-14.6
Home Furnishings	-6.7	Internet Retailers	-10.9
Computer Retailers	-6.6	Health-Care Supplies	-8.0

UTUAL FUNDS

EEK TOTAL RETURN
ENDED NOV. 8



EEK TOTAL RETURN
ENDED NOV. 8



tandard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	11.8	Precious Metals	53.4
Natural Resources	7.2	Latin America	40.6
Latin America	6.8	Pacific/Asia ex-Japan	36.7
Pacific/Asia ex-Japan	6.6	Diversified Emerging Mkts.	33.5
LAGGARDS		**LAGGARDS**	
Real Estate	0.3	Large-cap Growth	7.7
Financial	0.9	Health	8.4
Japan	1.1	Japan	8.6
Domestic Hybrid	1.8	Technology	8.9

EQUITY FUNDS

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Tocqueville Gold	17.3	U.S. Global Invrs. Gold	78.4
Oppenheimer Gold & Mins. A	16.3	U.S. Glbl. Invs. Prc. Mnls.	77.8
U.S. Glbl. Invs. Prc. Mnls.	15.3	Oberweis China Opport.	77.2
USAA Prec. Mets. & Mins.	14.6	Midas	72.8
LAGGARDS		**LAGGARDS**	
American Heritage	-12.5	Ameritor Investment	-88.9
ProFunds UltSh. Emrg. Mkts.	-12.0	DireXn. Emrg. Mkts. Short	-48.7
DireXn. Emrg. Mkts. Short	-10.5	DireXn. Sm. Cap Bear 2.5X	-29.8
ProFds. Sh. Prec. Mtls. Inv.	-8.7	ProFds. UltSh. Sm. Cap Inv.	-26.0

INTEREST RATES

KEY RATES

	NOV. 8	WEEK AGO	YEAR AGO
Money Market Funds	4.84%	4.81%	3.49%
90-Day Treasury Bills	5.10	5.06	3.96
2-Year Treasury Notes	4.75	4.64	4.41
10-Year Treasury Notes	4.63	4.56	4.55
30-Year Treasury Bonds	4.73	4.68	4.75
30-Year Fixed Mortgage†	6.09	6.10	6.19

†BanxQuote Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.78%	4.18%
Taxable Equivalent	5.40	5.97
Insured Revenue Bonds	3.83	4.32
Taxable Equivalent	5.47	6.17

THE WEEK AHEAD

AL BUDGET MONDAY, *Nov. .m. EST* » The Federal ment probably ran a illion deficit in October, say mists queried by Action mics. The shortfall was billion last October.

L SALES *Tuesday, Nov. 14, .m. EST* » October retail ikely inched up 0.1%. nber sales fell 0.4% on a lunge in gas station sales. autos, sales likely rose 0.1%.

PRODUCER PRICE INDEX *Tuesday, Nov. 14, 8:30 a.m. EST* » October producer prices probably fell 0.4%, after a 1.3% plunge in September. Excluding food and energy, prices very likely rose 0.2%, after a stout 0.6% gain.

CONSUMER PRICE INDEX *Thursday, Nov. 16, 8:30 a.m. EST* » October consumer prices for goods and services probably eased 0.2% on falling gasoline prices. Minus energy and food, the index most likely rose 0.2% for a fourth straight month.

INDUSTRIAL PRODUCTION *Thursday, Nov. 16, 9:15 a.m. EST* » October factory output is expected to have grown 0.2%, after a 0.6% dip in September. Factory utilization likely edged up to 82%.

RESIDENTIAL CONSTRUCTION *Wednesday, Nov. 17, 8:30 a.m. EST* » Housing starts probably cooled to an annual pace of 1.71 million in October.

The *BusinessWeek* production index rebounded to 284.1 for the week ended Oct. 28 and stood 9.6% above the previous-year level. Before calculation of the four-week moving average, the index rose to 284.6.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

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Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A
Abbott Laboratories (ABT) **99**
Abraxis Oncology **96**
AES (AES) **50**
Airbus **32**
Albertson's (ABS) **78**
Alcoa (AA) **50**
Ambience Builders **48**
American Express (AXP) **48**
Amgen (AMGN) **34**
Analog Devices (ADI) **20**
Aon (AOC) **70**
Aperion Group **78**
Apple (AAPL) **24**
Aquasale **48**
AT&T (T) **37**
Audi **32**
Aurora Organic Dairy **20**

B
Banamex (C) **66**
Banco Azteca **66**
Barclays (BCS) **112**
Bass Pro Shops **76**
Belardi/Ostroy ALC **76**
Bloomberg **13**
BMW **48**
Boeing (BA) **32, 114**
Boswell Group **18**
Brookwood Securities **20**

C
Cabela's (CAB) **76**
Campbell Mithun (IBG) **28**
Capital One (COF) **20**
Carlyle Group **32**
Cedar Fair (FUN) **70**
Cell Therapeutics (CTIC) **96**
China Mobile (CHL) **55**
Cisco (CSCO) **10, 56**
Citigroup (C) **56, 66**
Clayton Dubilier **32**
CLP Skilled Trade Solutions **78**
CNBC **28, 122**
Comcast (CMCSA) **28**
Cox Communications **28**
CreditSights **13**
CRT Capital **96**
Cushman & Wakefield **48**

D
DaimlerChrysler (DCX) **32, 52**
Davidowitz **76**
Decision Dynamics **82**
Dell (DELL) **16**

E, F
EADS **32**
Enron **13**
Ethanol Boosting Systems **99**
EverBank Financial **40**
ExxonMobil (XOM) **34**
FedEx (FDX) **32**
Fendi **48**
Ferrari **48**
Fidelity Investments **112**
Ford (F) **32, 52, 99**
Four Seasons (FS) **32, 42**
Fox News (NWS) **28**

G, H
Gartner Group **48**
GAZ Group **52**
GE (GE) **50, 114**
George C. Hopkins Construction **78**
Georgia-Pacific **74**
Giorgio Armani **48**
GM (GM) **32, 74, 112**
Goldman Sachs (GS) **13, 37**
Goodrich (GR) **114**
Google (GOOG) **32**
Gucci **48**
Halliburton (HAL) **16**
H&R Block (HRB) **40**
Hang Lung Properties **55**
Harrah's (HET) **82**
Hewlett-Packard (HPQ) **16**
Hindustan Construction **55**
Home Depot (HD) **78**
Honeywell (HON) **114**
Hormel Foods (HRL) **74**
Hovnanian Enterprises (HOV) **114**
HSBC (HBC) **48**
Huawei Technologies **55**
Hugo Boss **48**
Hutch **48**

I, J
IBM (IBM) **10, 16, 47, 82**
Integro Insurance **70**
Intel (INTC) **120**
Johnson Associates **32**
JPMorgan Private Bank (JPM) **112**

K, L
KBR (KBR) **16**
Kimaya Fashions **48**
Kleiner Perkins **56**
Knightspoint Partners **14**
Kohlberg Kravis Roberts **32, 42, 70**
Korn/Ferry **82**
Kroll (MMC) **70**
Labor Ready (LRW) **78, 82**
LDV **52**
Linden Lab **47**
L.L. Bean **76**
Lockheed Martin (LMT) **74**
Louis Vuitton **48**
Luminus Energy **48**

M
MagiQ Technologies **10**
Marsh & McLennan (MMC) **70**
Maserati **48**
MasterCard (MAS) **55**
Matrix USA **114**
McDonald's (MCD) **122**
McNamee Lawrence. **42**
Mercantile Potomac Bank **16**
Mercedes (DCX) **48**
Mercer (MMC) **70**
Merrill Lynch (MER) **32**
MGM **44**
Microsoft (MSFT) **24, 32, 82, 120**
Morgan Stanley (MS) **112**
Morningstar (MORN) **114**
MSNBC **122**
MusicGremlin **24**
Mydays **100**

N
National Garage **48**
Navnit Motors **48**
NBC **20, 28, 122**
New Century Financial **40**
News Corp. (NWS) **28**
Novartis (NVS) **96**
NovaStar Financial (NFI) **40**
NovaSterilis **99**
Novuspharma **96**

O, P
Option One (HRB) **40**
Outback Steakhouse (OSI) **42**
PayPerPost.com **18**
Penfolds **110**
PetroChina (PTR) **114**
Pfizer (PFE) **74**
PIMCO (AZ) **70**
PNC Wealth Management **42, 114**
Porsche **48**
Powerset **20**
Praxair (PX) **70**
Providence Equity Partners **44**
Peugeot (PEUGY) **32**
Putnam Investments (MMC) **70**

Q, R
Quinn Gillespie **34**
Rare Enterprises **48**
Reebok (ADDDY) **47**
Reprise **108**
Reuters (RTRSY) **47**
Rolls-Royce **48**

S
Salem Partners **44**
S&P (MHP) **114**
SBS Broadcasting **44**
Schaeffer's Investment Research **114**
Sharper Image (SHRP
Silver Lake Partners **3**
Sinopec **55**
Skoda **48**
Sony (SNE) **44**
Sony BMG Music **47**
Spartan Staffing **78**
SportsOneSource **76**
Stanley Works **70**
Starwood (HOT) **47**
structuredretailprodu com **112**
Summit Energy Servi
Sun (SUNW) **10, 70, 8**

T
Taj Palace Hotel **48**
Tata Steel **55**
Tavakoli Structured F **112**
Technopak Advisors
Telefónica (TEF) **14**
Texas Pacific Group **4**
Thomson Financial **2**
Time Warner (TWX) **4**
Time Warner Cable (T **28**
TNS Media Intelligen
Toll Brothers (TOL) **3**
Toyota (TM) **32, 52**
T. Rowe Price (TROW
TRW Automotive (TR
Tungsram **50**

U, V
U.S. Global Investors (GROW) **114**
U.S. Steel (X) **50**
United Technologies **114**
UPS (UPS) **37**
Valentino **48**
VeraSun Energy **99**
Verizon (VZ) **13, 32**
VF (VFC) **93**
Vivendi (V) **32**
VM Ware **10**
Vodafone (VOD) **14**
Volkwagen **32**

W
Wal-Mart (WMT) **48, ,120, 122**
Warner Bros. (TWX)
Webhelp Worldwide
Williams-Sonoma (W **76**
Willis Group (WSH) **7**

X, Y, Z
XenSource **10**
XM Satellite (XMSR)
YouTube **32**
Zurich Financial **82**

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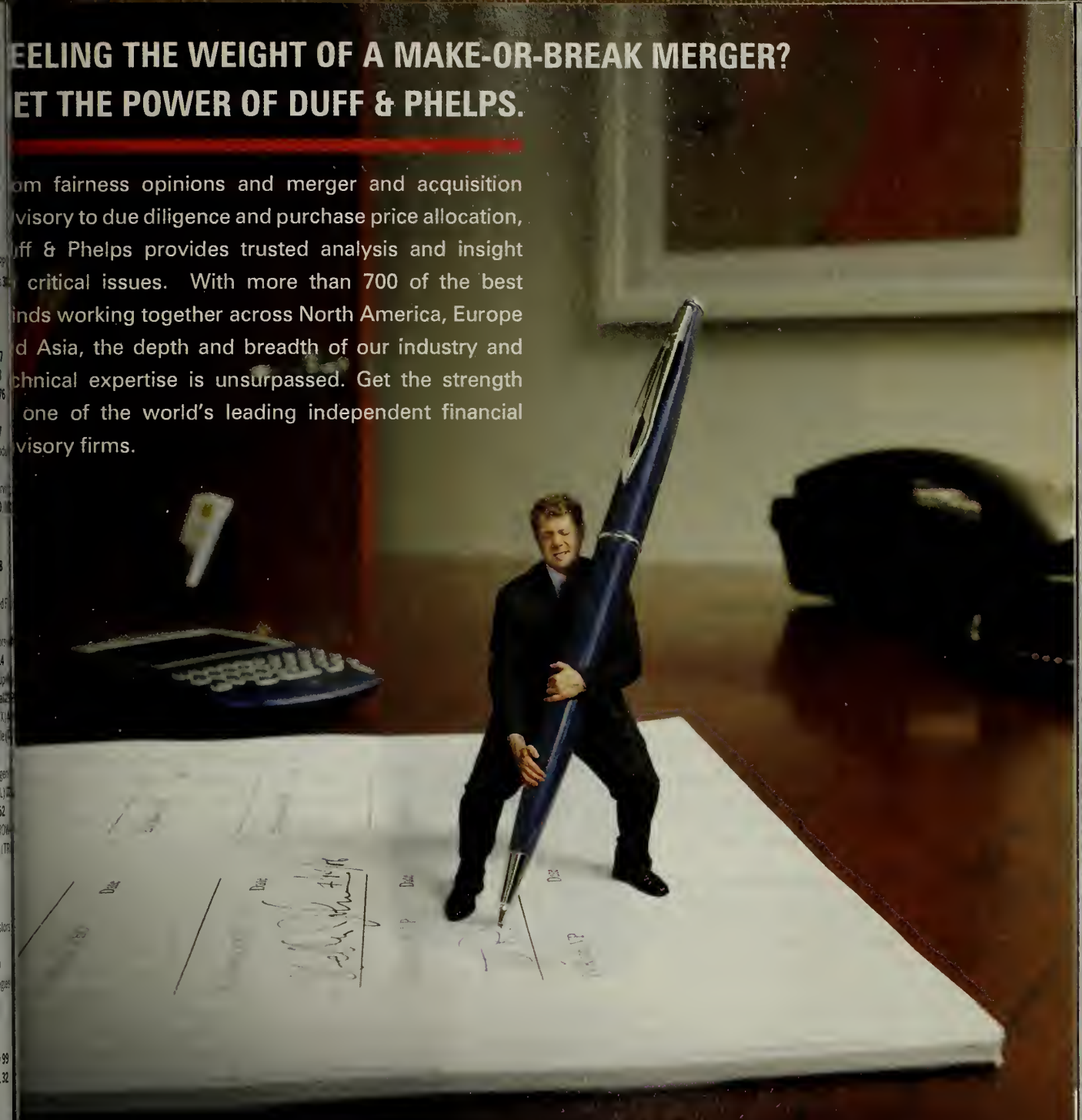

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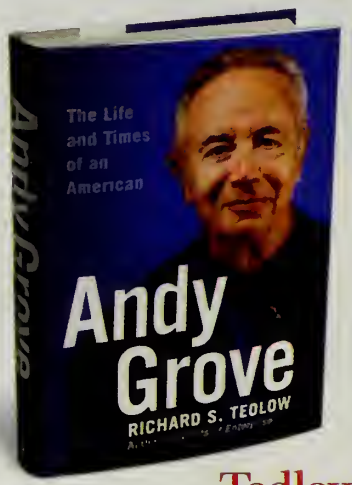
Inside the Mind of a Tech Titan

ANDY GROVE The Life and Times of an American
By Richard S. Tedlow; Portfolio; 568pp; $29.95

Andrew S. Grove is a living legend. The former Intel CEO has served as an adviser to presidents, been named *Time*'s 1997 Man of the Year, and been called the godfather of the personal computer. He is treated with reverence wherever he makes a public appearance and remains as outspoken today as he was during the height of his fame in the late 1980s through the 1990s. A prolific writer himself, Grove has been the subject of a good many books and articles.

All of which prompts the following question: Was it a fool's errand for Harvard Business School historian Richard S. Tedlow, author of *Giants of Enterprise: Seven Business Innovators and the Empires They Built* and other works, to spend years trying to uncover little-known facts and great insights about one of the seemingly best known men in business?



Yes and no. In *Andy Grove: The Life and Times of an American*, Tedlow has skillfully created one of the most comprehensive narratives of Grove's life and work. It's rich in detail, often humorous, and engaging. More than anything that has come before, this volume lets you inside the titan's mind as he took on more managerial responsibilities. Tedlow also guides us through business history, offering impressions of CEOs both famous (Lou Gerstner, Steve Jobs, Andrew Carnegie) and infamous (Dennis Kozlowski, Bernie Ebbers, and Jeffrey Skilling) and comparing them with Grove, who overall gets better marks. The book's accomplishments are considerable. But in spite of them, many readers will be left longing for more personal details and insight into a man who regularly reinvented himself and his company.

Much of what is in the volume will be familiar to business readers. The first 60 pages describe the life of young Grove, born András István Gróf, and his escape from communist Hungary. The material here is similar to that in the Intel chief's best-selling memoir, *Swimming Across*. Then, following a brief account of Grove's emigration to the U.S. and his college years, there's a lengthy treatment of his struggles and fear of failure during the early years of Intel, when Grove served as operations director under co-founders Robert Noyce and Gordon Moore. The uninitiated will find this fascinating. Those familiar with Grove's story may anticipate where the author is leading—toward a conclusion that Grove's success owed much to his ability to make coldly calculated decisions, such as the one to dump Intel' memory-chip business and focus on microprocessors. Lat chapters describe the company's growth pains, crises, anc struggles to adapt to the rapid technological change that swept the world.

Through it all, Tedlow delivers sharp, colorful anecdotes provide insight into not just the life of Grove and the histor of Intel but also a young Silicon Valley full of promise and ambition. The author gathered material during a year spen sitting in a cubicle at Intel's Santa Clara (Calif.) headquarte where he interviewed key executives and other employees. Most significant, he has drawn on Grove's o account of events as described in personal journals. Tedlow uses these to chronicle the executive's wit and moments of doubt and satisfaction, along with his Herculean effort stay abreast of the company's progress. In an entry from 1971, for example, Grove observe that "Management is the art of absorbing a in one lump from above; cutting it into sma lumps and pushing them down one level."

Some of the most intriguing moments o when Tedlow talks about the early relation between Microsoft and Intel, which later morphed into the Wintel alliance. He recou a dinner meeting at Grove's home with Bill Gates that devolved into a shouting match. Gates had referred to a project as "actional by which he meant simply t work could proceed. Grove misunderstood the statemer thinking it was a warning o a lawsuit. "Do you mean to threaten me with legal actio at my own dinner table?" he shouted. The brouhaha ultimately died down, but G says he was the only one pre to finish his salmon.

Tedlow offers fresh insights into Grove's thinking but little that's new about his personal life

The book falters as it rac its end. We learn about Gro health problems, including battle with Parkinson's dise but there's little analysis of Grove's legacy. His personal l save for what already is widely known, remains relatively unexplored as well.

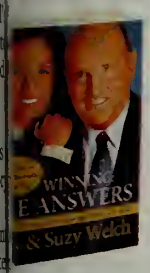
In his introduction, Tedlow quotes three "wealthy and powerful" people who ask whether he can construct a wo that shows how Grove thinks, how he made key decision and "all the stuff that he won't tell you about." In the enc Tedlow falls short—but two out of three ain't bad. ■

–By Cliff Edw

BusinessWeek Writers

ear Jack & Suzy

NING The Answers
ıck & Suzy Welch; Collins;
ıp; $12.95



He has been CEO of a huge corporation, penned two best-selling books, and taught at the Massachusetts Institute of Technology, among other things. And lately, Jack Welch has n on a new position—as the Dear / of the world of work.

elch first assumed this role in 005 book, *Winning*, wherein he onded to questions raised during king engagements. In his latest orial outing, *Winning: The Answers*, ritten with wife and former *ard Business Review* editor Suzy h, the busiest ex-CEO on the planet s 74 new queries, posed in e-mail or rson by often-perplexed managers, ents, employees, and entrepreneurs. ıe of the material has appeared e in the authors' *BusinessWeek* nns.) The Q&A covers six broad s: global competition, leadership, agement, careers, family enterprise, he virtues of business. There's a rally upbeat, commonsense tone e responses, though the Welches times exhibit a smidgen of tion. All in all, the duo seems to be ng a good deal of fun.

ıe authors' career tips appear to have k a chord with the public. "Without t," they note, "the majority of the ions we receive...are about career ıgement." As a result, that subject more space than almost any other e book (56 pages), running second to Jack's true passion, management ages). And the volume considers ategories that went undiscussed *inning*: entrepreneurship/family ıess and current events—the latter pted by recent corporate scandals. ontroversial passage, the authors hat Wal-Mart is "a great company ıelps consumers and employees nd grow." A matter of opinion? f course. ■

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Post-Election Economy: With strong Democrat wins, how could the mid-term results affect the economy and consumer spending in the months to come?

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IdeasFaceTime
WITH **MARIA BARTIROMO**

Should Business Be Worried?

CHARLIE COOK is one of the preeminent political analysts in America. If you're a journalist covering politics, you read Charlie before you get out of bed. Cook publishes a nonpartisan newsletter, *The Cook Political Report,* and is a political analyst for *National Journal* magazine and NBC. When I caught up with him, he was taking a train back to Washington from New York after a long night of Election Day coverage for NBC, where his team was first to call the power shift in the House.

How worried should business be about the outcome of this election?
I don't think the business community as a whole is worried because no one has...a working majority. The markets like paralysis. Now if I were a pharmaceutical company or an oil company or a managed-care company, I'd worry.

Why oil and pharma?
Drug reimportation [Americans buying U.S.-made prescription drugs from other countries at prices lower than available at home] is probably a done deal. There is a strong chance we will get Medicare to negotiate prescription drug prices. And some of the tax treatment that oil companies have had, the incentives to drill, I'd worry about those if I were an oil company. But the Dems are only going to have a slight margin in the House...five seats more than what Republicans have had. That's a tiny majority. Anyone who uses the word control, as opposed to majority, in the context of the House and Senate...is just wrong. What will it be in the Senate...51-49?

What will the top three economic issues be for Democrats in the new Congress?
[Presumptive House Speaker] Nancy Pelosi has her talking points out there—income equality, raising the minimum wage, but the business community doesn't care about that. I mean will McDonald's and Wal-Mart be unable to pay minimum wage? Of course not. There are very few businesses that pay anyone minimum wage anyway. It's a false issue.

COOK Dems don't want to declare war on business

Can business expect any relief from Sarbanes-Oxley?
No. No one wants to crack open Sarbanes-Oxley. No one th it will get cracked open in the next year or two. What busi people want is certainty. They are not crazy about [Sarb but they don't want the rules changed every year either. T just spent an enormous amount of money complying... don't want to pay $100 million to change the policy again

Lots of Americans find themselves in dire straits: No more equity to get out of their homes and big credit-card bills. Pl Republicans made it tougher to declare personal bankrupt Will the Dems try to rein in credit-card companies?
The Democrats will not have the votes to start taking a every segment of the business world, no they have the desire. It would be suicida the Democratic Party to declare war on business community. Look at Pelosi's 100 hours list, and you'll see her prior They are pretty innocuous. They remin of the Contract with America. Not a l controversial stuff because the Dems have the votes to win any fights that are ribly controversial.

Immigration reform is enormously impor to business. Where will that be on the Democratic agenda?
I have never seen that on any priority Dems have remained very silent on this i and why shouldn't they? Republicans torn themselves apart [over it].

Iraq played a big role in this election. I significant were economic and pocket concerns?
I think Iraq...is about 70% of what happ in this election. It was a repudiation of th and of President Bush, and scandals were tiary importance. Economic and business i were very small—a fourth or fifth priority. The economy is wo Michigan than any place in the country, yet no incumbent lo

Is there any correlation with the housing market—for exa increased concern in softening markets?
No, that will be next year's crisis. When you have 10 milli 15 million people in danger of having their homes reposse that will be an issue.

Maria Bartiromo is the anchor of CNBC's Closing Bell.

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IdeasTheWelchWay

BY JACK AND SUZY WELCH

From the Old, Something New

How do you transition a U.S.-centric company into a truly global enterprise?

–Rich Rosier, Bedford, Mass.

You begin by hoping that your leadership team becomes out of its mind with excitement about the prospect of going global. Because for a company to launch a major geographic expansion—or to start any new venture from inside the "old" one, for that matter—the vision and the energy must come from people with real sway, and it has to come in buckets.

It's not that organizations intentionally oppose organic growth. It's just that any new venture soaks up money and attention, and too often, when people in the old, profitable part of an organization see cash and boss-interest flowing away from them, they balk. "Why is the company pouring money into that stupid idea?" they grouse, "We're the ones with all the earnings around here, and now we're not getting enough to reinvest."

Maybe they have a point, but it can't matter if you want to start something new. A venture won't make it with hedged bets, help delivered in teaspoonfuls, or a wait-and-see approach. No, if companies want an initiative to thrive, top managers have to use the old Robin Hood method: Steal from the rich to give to the poor. And the first thing they have to steal is people—great people, that is, to run the venture.

> People are sure to grouse: "Why are we spending money on that stupid idea?"

Too often, the tendency of top management is to hand a risky new initiative over to expendable Fred, who has two years left before retirement in a job he didn't do particularly well to begin with, or to high-potential Sally, a very young manager who, while good, doesn't yet have a strong embedded reputation in the company. Wrong. They have to send in real stars—highly respected people already in high-visibility positions. That bold gesture gives a venture its best chance to hit the ground running, and it sends a critical message to the organization: This thing is for real.

Along with appointing high-profile stars, senior managers can bolster organic growth initiatives in two other ways. They should make an exaggerated commotion about the potential and importance of the new venture, frequently visiting its operations and putting themselves on the line by cheerleading its small victories at every opportunity. And should back up that cheerleading by having the new vent report at least two levels higher than sales would justify. Visibility matters!

Finally, if managers really want a seedling to grow, the need to give it some space. Yes, that may sound contradic But supporting a venture doesn't mean controlling its ev move. If you've put great people in charge, you have to le them go for it. Their best chance of success comes from t freedom to take risks.

We wrote about mergers and acquisitions in this space few weeks ago, praising it to the skies as a powerful way grow. But starting something homegrown—the new fron inside the old—can be one of the most exhilarating aspec of being in business. In your role in your company, you m not be able to lead the charge to globalization, but you're already helping by welcoming change. Now let's hope yo leadership will, too.

Is it O.K. to have a friendship with the people who report to

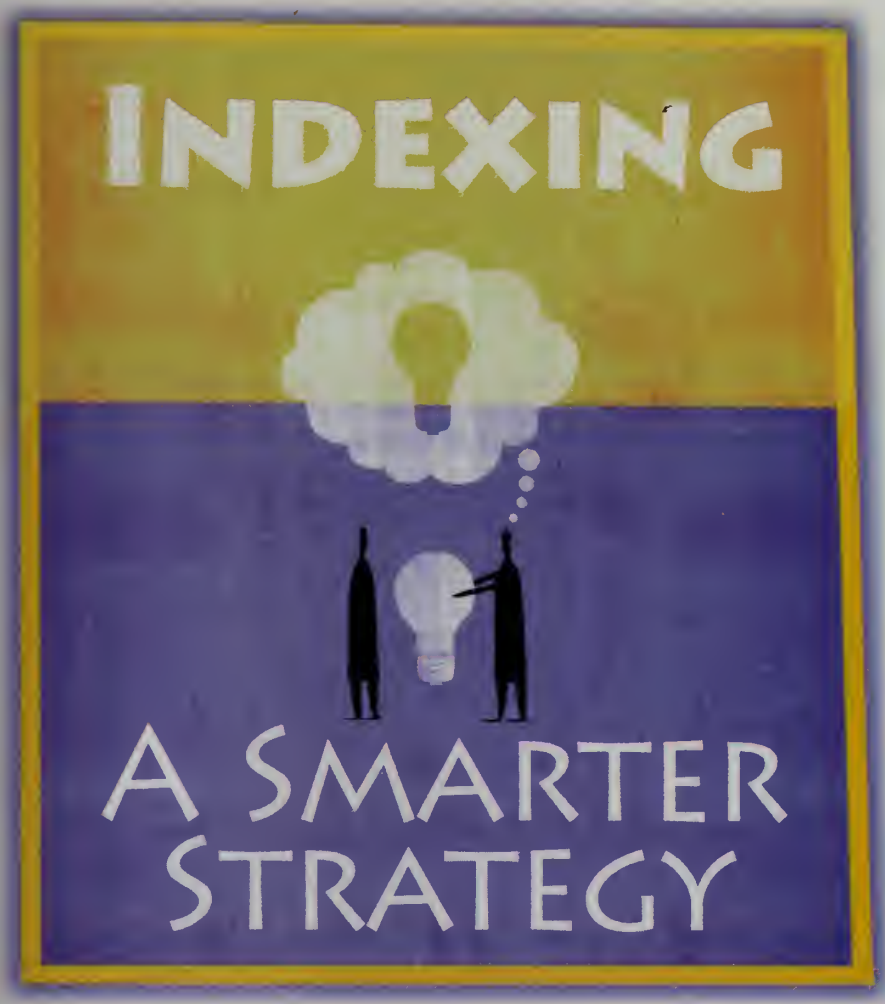
–Craig Roberts, Purchase

It's certainly nothing to be afraid of! Of course, you don't need to be friends with your subordinates, as long as you share the same values for the business. But if you are frie with them, lucky you. Working with people you really lik 8 or 10 hours a day adds fun to everything.

That said, remember that boss-subordinate friendship live or die because of one thing: complete, unrelenting candor. Candor is imperative in any working relationshi but it's especially necessary when there's a social aspect involved. You don't want your liking someone's personal to automatically communicate that you like his or her performance. You may, but performance evaluations hav come in a distinct and separate set of conversations at w as often as four times a year—in which you sit down wit your subordinate, put the shared laughs from last weeke barbecue in the corner, and talk about what's expected a what has been delivered.

Do these candid conversations require a certain abilit compartmentalize? You bet they do. But when you recog that fact and practice discipline, confident you're being f everyone, you should be able to enjoy one of work's best in perks: hanging out with friends. ■

Jack and Suzy Welch look forward to answering your question about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their week podcast, go to www.businessweek.com/search/podcasting.htm*



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SECRETS, LIES, AND SWEATSHOPS

How Chinese suppliers hide the truth from U.S. companies

BY DEXTER ROBERTS AND PETE ENGARDIO (P.50)

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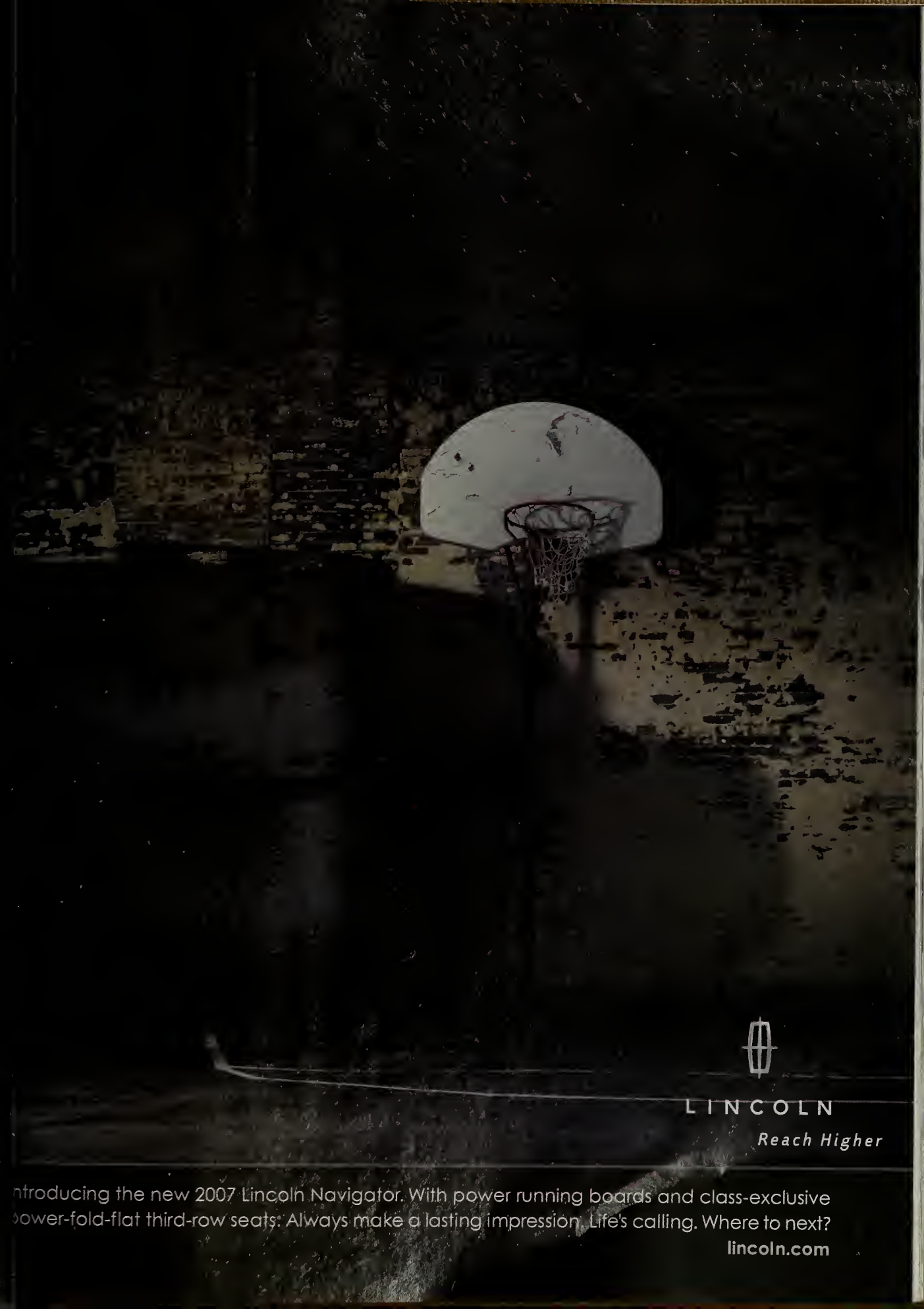
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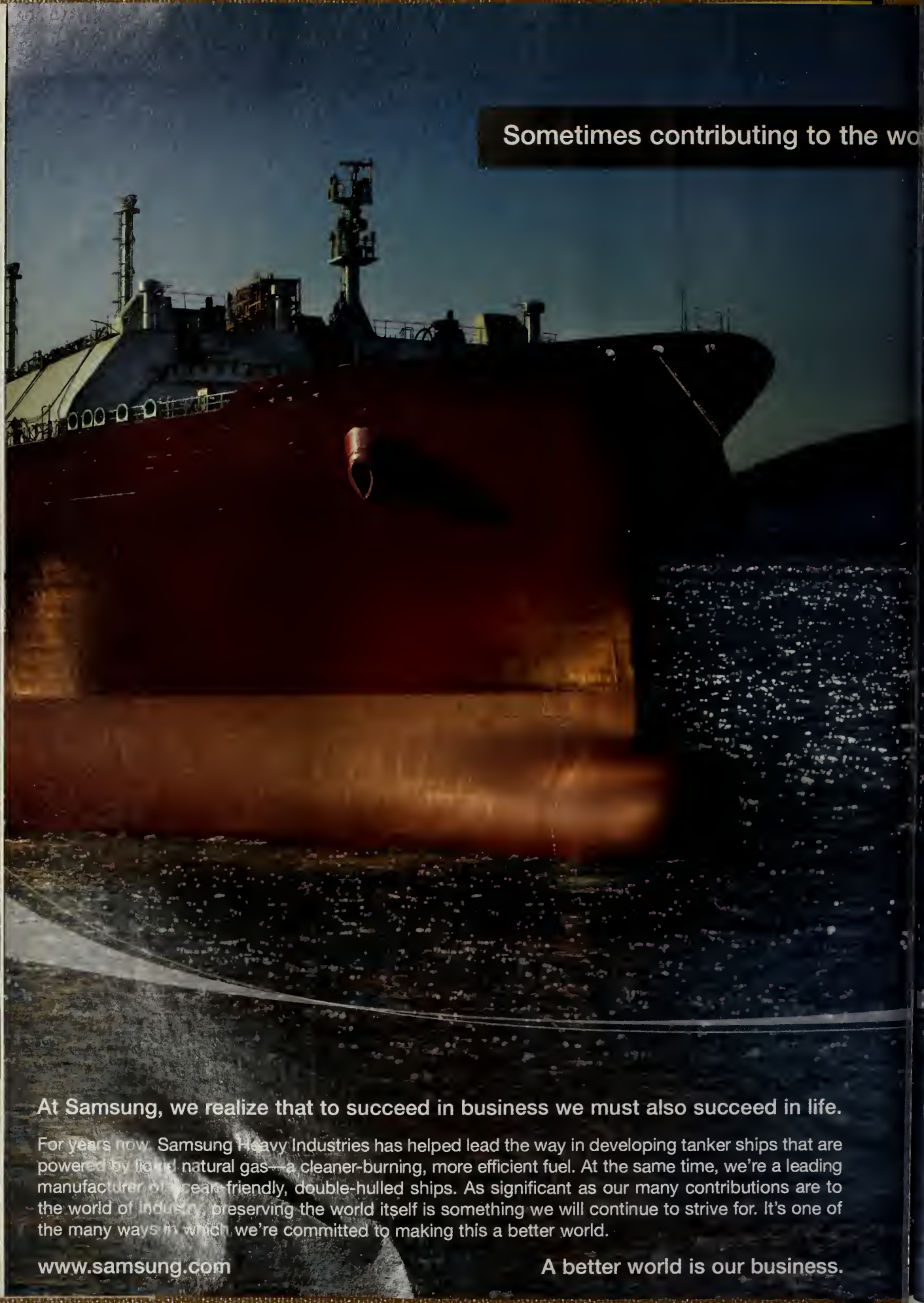

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Airways' offer for Delta; plans for a w European bourse; private equity als in the making; and more

ews & Insights

4 Stuck in the Slow Lane in Japan
ling GM there is tough. But Antonio ra has big ambitions

5 Today US Airways, Tomorrow...?
e surprise bid for Delta could trigger a g-predicted merger mania in the sky

6 Ammo for a Higher Minimum Wage
w research says a ripple effect uld raise the pay of a lot more family adwinners than previously thought

) London's Freewheeling Exchange
winning the listings war against New k, but investors could get burned

: Microsoft Thinks Thin
leading the private sector in doing nething about obese employees

lobal Business

4 'Wal-Mart with Wings'
land's Ryanair, which took its cues m Southwest, has taken penny- ching to new extremes

) Searching for an Encore to Skype
e VC that won big on Skype is uring Europe for the next big thing

6 Land of the Lilliput-Putt
anese drivers are mad for minicars, a nd that's helping Suzuki and others

RE GLOBAL COVERAGE:
additional insights into European l Asian business, please go to w.businessweek.com/globalbiz

conomics

2 Business Outlook
Cooper says exports are on a tear, l the timing for the economy couldn't better

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Cover Story

50 Secrets, Lies, and Sweatshops U.S. companies, burned by charges that they exploit Chinese labor, put in place strict work rules and increased factory inspections. But a *BusinessWeek* investigation finds that a mini-industry has sprung up to help Chinese suppliers hide abuses

58 Making Factories Play Fair What multinationals are doing

NEWS & INSIGHTS

32 Death of the Car Salesman Not so long ago selling cars was one of the best ways to make a living without a college degree. But the go-go days are gone: Profit margins are lower, commissions are smaller, customers are savvier, and there are simply too many dealers

CONTENTS

IN: *INSIDE INNOVATION*
(OPPOSITE PAGE 58

IN: *Inside Innovation*

Ideas, Tools, and Lessons
(OPPOSITE PAGE 58)
Kodak's struggle to reinvent itself; real-world businesses in Second Life; and more

Finance

59 Media's Favorite Control Freak
Why startups love venture capitalist Alan Patricof

60 A Dicey Win for Blackstone
It bought out Freescale, but the debt load jeopardizes the chipmaker's future

The Corporation

62 Did the Election Spur a Drug Deal?
Politics and CVS's buyout of Caremark

Government

64 How Bill Clinton Helped Boost CEO Pay
A law he championed backfired

Marketing

66 It's Miller Time in China
SABMiller's Snow beer is flooding the country's rural regions

Science & Technology

68 Wild Fixes for Global Warming
Scientists are dreaming up big, risky ideas to save the earth

Special Report

72 A Golden Year for Giving
The names and bequests on our annual survey of philanthropy are bigger than ever before

76 Taking Tiny Loans to the Next Level
The titans of tech embrace microfinance

82 A Big Stage for Microfinance
Nobel winner Yunus spreads the word

84 Giving Goes Green
Small companies back the environment

Executive Life

94 What's in Santa's Gift-Book Bag?
Monkeys, paintings, the history of baseball, and a whole lot more

96 Working Out with Jim Karas
His program is perfect for road warriors

98 Napping Your Way to the Top
More companies O.K. a midday snooze

100 Putting Your Best Beard Forward
From facial fuzz to fashion statement

Personal Finance

104 What Does Your Health Plan Pay?
You need to do lots of digging to find

108 Inside Wall Street
Gene Marcial's stocks to watch

110 Figures of the Week

Ideas

116 Books
Nasaw: *Andrew Carnegie*

118 Outside Shot
Adding practice to theory in B-school

Columnists

24 Steve Wildstrom: Tech & You
Two worthy rivals for the Q smart pho

26 Jon Fine: MediaCentric
NBC Universal may soon produce ads

102 Robert Parker: On Wine
Ten zinfandels worth giving thanks fo

120 Jack and Suzy Welch: The Welch W
Work-life choices, not work-life balan

Features

13 UpFront
20 Readers Report
114 Index to Companies

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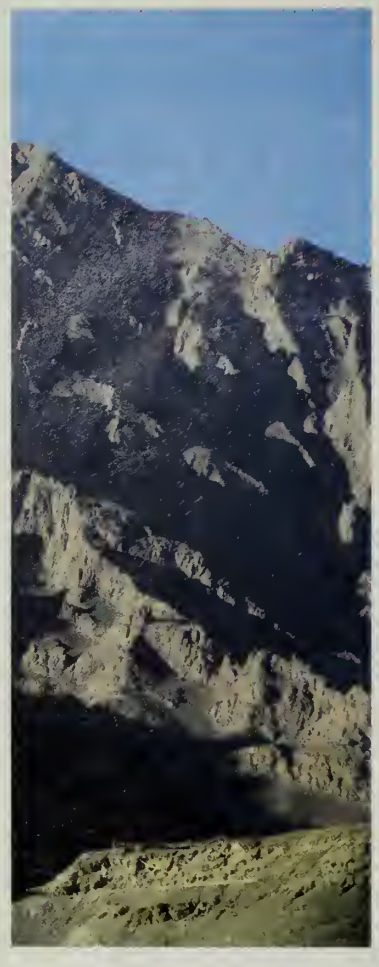

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The Need For Speed

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Superheroes, supermodels, superstars. Most things "super" enthrall the 12-year-old in all of us, but few more so than superca The reason is that they are **superior in performance** and status in wa that make regular cars—even expensive luxury autos—seem poky and unexciting. Our BusinessWeek.com **Special Report on Supercars** focuses on these achingly beautiful and incredibly expensive machines. We present a detailed look a the world's top 10 supercars, featuring such **modern thoroughbreds** as the Pagan Zonda, and pay homage to the earliest supercars, including the Bugatti Type 41. For **a current view of the business,** we interview Henrik Fisker, former design chief for BMW and now head of his own eponymous company. And we profile Spyker, the small Dutch supercar maker, which, unlike many larger, better-known rivals, is actually about to turn a profit Last, we offer **practical advice** on how you can go about driving one of these beauties out of the showroom. (When something can go over 200 mph and costs upwards of $250,000, it isn't as simple a handing the dealer your credit card.) For all this and more, go to **www.businessweek.com/go/06supercars.**

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JPFront

DITED BY DEBORAH STEAD

"Investors in the target company are...'squeezed out' at artificially low valuations."

–An investor suit filed in federal court in Manhattan on Nov. 15 accusing 13 private-equity firms, including KKR and Carlyle Group, of rigging the market to take companies private

MONEYMEN

THE LATEST INVASION OF NORTH AFRICA

HE PRIVATE-EQUITY boom is tending into almost every rner of the globe—even, rhaps, into Colonel uammar Qaddafi's Libya.

vo Libyans with Western vestment bank experience, lel Saudi and Abdulla ulsien, have set up **Tuareg pital** to invest in Libya (and xt door in Algeria). "We e a great opportunity to ist in the restructuring the country," said Saudi, Tuareg's chairman, speaking from his Bahrain office. Saudi hopes to have $30 million raised by yearend and to eventually put together $100 million for investment in health care, oil services, tourism, building materials, and other sectors. The group is getting initial backing from Bahrain-based **ASA Consultants** and **United Gulf Industries**.

Through the companies he hopes to set up, Saudi wants to introduce top foreign firms to the Libyan market, now that Qaddafi has handed over his weapons of mass destruction program to the U.S., welcomed back American oil companies, and even brought in **Harvard Business School's** Michael Porter as an adviser.

For Tuareg, it's still early days. "We're trying to iron everything out," Saudi says. "Libya is not an easy country to do this in, you know."

–Stanley Reed

HE BIG PICTURE

HE AVERAGE big U.S. company is a defendant 305 lawsuits pending worldwide, concludes a ew survey, with insurers facing the most dividual lawsuits (1,696 per company on verage). A third of those surveyed are efendants in one or more class actions.

rcentage of companies facing at least one U.S. class action, by industry

SURANCE	69%
ETAIL/WHOLESALE	65%
ANUFACTURING	51%
ANKING/FINANCIAL SERVICES	43%

: Fulbright & Jaworski LLP, 2006 survey of 311 in-house lawyers

MONEY AND POWER Obey, Byrd, and Pelosi step in

THE NEW CONGRESS

A Change in Political Fortunes

TALK ABOUT a wealth gap: The Democratic takeover of Capitol Hill means two of the poorest men, by congressional standards, will control the committees that spend billions of taxpayer dollars. According to the **Center for Responsive Politics**, Robert Byrd (D-W.Va.), the likely new chairman of the **Senate Appropriations Committee**, is worth somewhere between $231,006 and $616,000, ranking 81st in the Senate. His counterpart on the **House Appropriations Committee**, Dave Obey (D-Wis.), ranks a lowly 358th in that chamber, with assets somewhere between $35,007 and $175,000.

"Somewhere between" because on their disclosure forms, Congress members estimate each of their assets by checking off 1 of 11 brackets: $1,001 to $15,000, the lowest, or $25 million to $50 million, the second highest, followed by "over $50 million." Democrats say legislators with less wealth relate well to the middle class. Conservative Grover Norquist, head of **Americans for Tax Reform**, grumbles that a lack of riches is no guarantee "that they'll treat your money with respect. These Democrats will amaze you with their feats of fiscal largesse."

Don't cry for the new majority just yet. Presumed Speaker of the House Nancy Pelosi (D-Calif.) is worth up to $55 million. Among her assets: stakes worth as much as $25 million in a California vineyard and $1 million in a golf course.

–Eamon Javers

UPFront

PERFUME

WAKE UP AND SMELL THE GUM

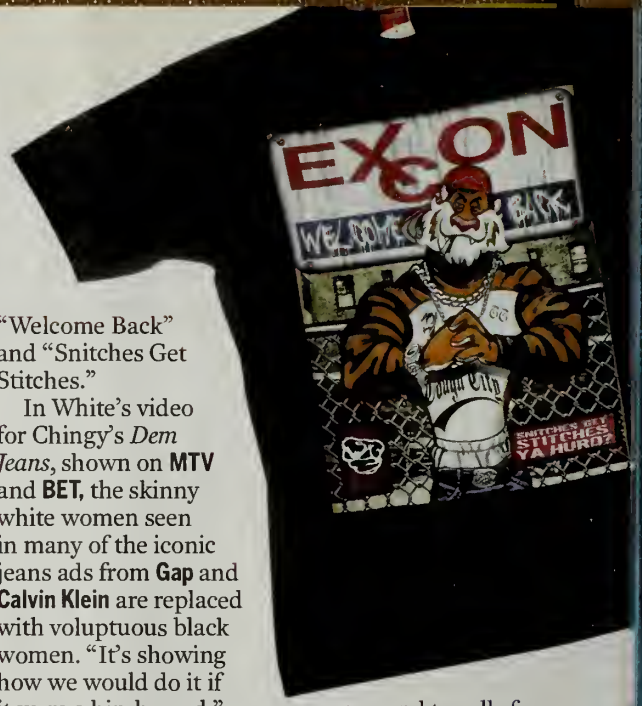
A new Japanese confection line, Fuwarinka, promises to double as a perfume.

All the rage in Japan and now available internationally, the gum and candies contain chemicals derived from roses and vanilla beans—compounds that are secreted through the skin one to two hours after chewing the gum and three to four hours after eating one of the sweets. The confections come in both "fruity rose" and "fresh citrus" flavors. But because the chemicals responsible for taste differ from those for smell, researchers say, the gum always produces a rose perfume, the candies, a vanilla scent. Consumer-products giant **Kanebo** developed the line with a former chemistry professor at **Nagoya Institute of Technology.** Since the August, 2005, debut, Kanebo has sold 2 million units at the equivalent of $1 a pop. A rose menthol gum for men introduced in July, 2006, has sold out faster than stock can be replenished, Kanebo says. Compactimpact.com, which offers hot-ticket Asian items to Americans, says Fuwarinka sells well on its Web site.

–Aili McConnon

LOGO WATCH

A REMIX FOR SOME BIG BRANDS



HIP-HOP ARTISTS have long mixed cuts from classic records or turned city walls into canvases for graffiti art. Now they're getting creative with corporate logos and ads, too. "We take the ad and flip it," says Erik White, who directed recent music videos by P. Diddy and rapper Chingy, "to influence the companies right back."

The parodies, in videos and on clothing, are as much *Mad* Magazine as Gangsta Rap, punning on brand names or making a wry commentary on the ads themselves. On a T-shirt (above) sold by **Tough City,** a New York distributor, what looks like "Exxon" is actually "Ex-Con," with a muscled version of the Exxon tiger and the words "Welcome Back" and "Snitches Get Stitches."

In White's video for Chingy's *Dem Jeans*, shown on **MTV** and **BET,** the skinny white women seen in many of the iconic jeans ads from **Gap** and **Calvin Klein** are replaced with voluptuous black women. "It's showing how we would do it if it were a hip-hop ad," White says. (Twisting the Gap slogan, the video urges: "Fall into the hood.")

What do the brands make of this? Shown a photo of a T-shirt featuring a drug-dealing Pillsbury Doughboy in front of a pile of cash and cocaine, a **General Mills** spokesperson responded: "This is an unauthorized infringement on our trademark, and we will take appropriate action." **ExxonMobil** and Gap did not respond to calls for commen

If companies like Genera Mills do fight back, the sma designers face steep odds. Earlier this year, Congress expanded trademark laws to make it easier for brands to sue. Tough City's chief, known as Supreme, says tha word of company threats le his designers to give up on the T-shirts. "It was big last summer, but we're moving on," he said. "Not everybod found it funny." *–Burt Hel and Paula Lehma*

ART OF THE DEAL

ONE LESS POKER FACE TO KEEP

IS AUTOMATION dealing out the casino dealer? The makers of new, automated gaming tables say no, although the tables have buttons, cash slots, and video screens—dealers, chips, and cards aren't needed. **International Game Technology's** Multi-Player Series, for instance, lets up to 10 people place bets on touch screens while viewing images of baccarat hands or roulette wheels on a central screen.

The new tables will allow casinos to offer poker games popular online but not profitable with live dealers. The game makers also say the tables speed the pace of play. "There are fewer mistakes, so you get to play more poker," says CEO Lou White of PokerTek, which this year hopes to put 75 of its PokerProX series tables at

joints like **Hollywood Park Casino** near Los Angel and **Seminole Hard Rock** casinos in Tampa and Hollywood, Fla. The tables have yet to hit Las Vegas o Atlantic City, where state rules require extensive product trials.

For its line of poker and blackjack tables, gaming equipment supplier Shuffle Master has even included cyberdealers: video images of actors who appear on screens. They're so popular at **Dover Downs Hotel & Casin** in Dover, Del., that the casi is using them in billboard ads—after digitally coverin two of the women in eveni dresses, out of concern tha their original outfits reveal too much cleavage.

–Christopher Palm

Controlling Diabetes

Fulfilling Dreams

Science For A Better Life

Millions of people are diagnosed with diabetes every year. Some 195 million worldwide live with the disease, many of whom are children.

Thankfully, diabetes has become largely controllable – but it is crucial to know how to manage it if secondary illnesses are to be avoided. This depends on regular, accurate measurement of blood sugar levels.

Bayer HealthCare is working to make testing even more rapid and convenient. Using a device that safely measures blood sugar in the shortest of times, for example.

That's the best basis for successful treatment – and the foundation for enjoying as normal a life as possible. www.bayer.com

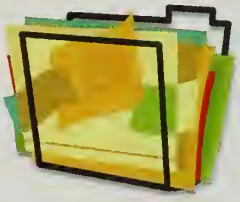
Bayer: CropScience MaterialScience HealthCare

UPFront

CREDIT CHECK

GIVING MORE WEIGHT TO 'THIN FILES'

MORTGAGE applicants with scanty credit histories, "thin files" in banker lingo, are typically shunted into subprime, or riskier, loans with superhigh interest rates. The hefty monthly payments can leave these homebuyers so strapped that they wind up in default.



Now a corporate partnership is building on the work of a nonprofit housing group to help more thin-file families get lower-priced loans. The idea is to grant mortgages based on credit factors that are currently ignored—a history of on-time payments for rent, utilities, insurance, or child care.

The nonprofit **Neighborhood Housing Services of America** has arranged such loans for about 25 years. But its program has been small: The process wasn't automated, and the costs were high. Enter **First American Corp.**, which recently distilled NHSA's lending practices to create Anthem, a fast, automated credit-scoring system for thin-file applicants. Already, the company says, it has compiled a directory of more than 200 certified loan officers that use Anthem in granting mortgages.

On Oct. 24, **State Farm Group** announced it would buy up to $100 million worth of such mortgages. The hope is that once the new system shows thin-file loans to be good business, mainstream lenders and mortgage buyers like Fannie Mae and Freddie Mac will dive in. *–Peter Coy*

MICROSOFT
1978

THAT '70s TECH GANG

IT'S EASY TO forget that Albuquerque was an early PC hot spot, home to Microsoft and MITS (creator of one of the first "microcomputers") in the 1970s. But a permanent interactive exhibit opening at the New Mexico Museum of Natural History & Science, conceived of and funded by Microsoft co-founder Paul Allen (first row, far right, above) should help the city reclaim its place in computing history. "STARTUP: Albuquerque and the Personal Computer Revolution" opens on Nov. 18 with plenty of geek artifacts: iconic computers (the Altair 8800), video games (*Space Wars*), and a replica of Apple co-founder Steve Wozniak's hobbyist desk, for instance. The gallery is a quick hop from the building that first housed Microsoft. *–Elizabeth Woyke*

PS3 VS. XBOX

FUN AND GAINS

» **IT'S AN** old story in the video game business: Sell the console at a loss, and make up the difference on games. An analysis by market research firm iSuppli, based on the cost of components, estimates that, for its new PlayStation 3, Sony is losing as much as $307 on every $499 model it sells. (The estimated loss on the $599 model is $241.) Meanwhile, iSuppli says, Sony's main gaming rival, Microsoft, will probably be turning a profit on sales of its Xbox 360 by next year. The cost of building an Xbox 360 has dropped to $323, from $470 a year ago, providing a gross margin of $76 per unit instead of last year's $71 loss. *–Arik Hesseldahl*

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Lipper Large-Cap Growth Funds Average	3.53%	3.60%	5.37%
Value Fund	**14.82%**	**10.43%**	**10.99%**
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TAXING MATTERS

THESE GIFTS DON'T KEEP ON GIVING

BRICE MARDEN'S *Couplet IV* hangs at New York's **Museum of Modern Art** (MoMA), where it's part of an exhibit of Marden's work that will run through Jan. 15. **Lehman Brothers** Chief Executive Officer Richard Fuld and his wife, Kathy, have the right to display the painting on their walls, too. When they acquired it, they agreed to gradually transfer ownership to MoMA in installments, or "fractional" increments.

Now a little-noticed section of the newly passed Pension Protection Act threatens to dry up such donations by ending an attractive tax break, and museums and donors are raising a fuss. "Many of our most important works come through fractional gifts," says Glenn Lowry, director of MoMA, where such gifts typically make up 20% to 40% of annual contributions.

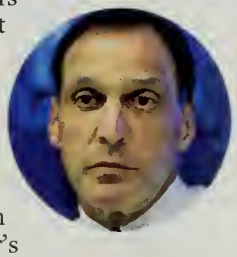
Museums, increasingly priced out of the lofty acquisitions market, like fractional gifts. While they must share possession of a work for an agreed amount of time, they eventually become sole owners. Under the old law, donors were happy, too. They often got generous display rights—and a tax deduction covering the fraction of the market value donated in any given year.

Under the new rule, deductions are capped at the art's value at the time of the first fractional gift. And if the art appreciates, donors will owe the IRS a gift tax of up to 46% of the gain given away in a fractional donation. The new law also requires museums to take full possession within 10 years or at a donor's death, whichever comes first. Otherwise, all past tax deductions are forfeited.

Backers of the new law contend some wealthy donors have abused fractional gifts by getting inflated appraisals to maximize tax benefits and by failing to share custody. "It isn't right for a donor to get a big tax break for supposedly donating a painting that hangs in his living room," says Senate Finance Committee Chairman Chuck Grassley (R-Iowa).

The museums, which helped to overturn a 1986 law that reduced tax breaks for art donations, are lobbying again, with some success. Senator Charles Schumer (D-N.Y.) is already on board: "This bill will have a huge negative impact on donations, all to stop phantom abuses. We must find a better solution in the new Congress." The Joint Committee on Taxation of the 109th Congress had estimated the rule change would increase tax revenues by about $77 million by 2011.

–Anne Terges



ON DISPLAY Richard Fuld and his "fractional gift" to MoMA, Brice Marden's *Couplet IV*

QUESTION OF THE WEEK

What will a Democratic Congress mean for immigration reform and relations with Cuba? *BusinessWeek*'s Mexico bureau chief Geri Smith asked former Foreign Secretary of Mexico Jorge Castañeda, a political science professor at NYU

"There will likely be bipartisan immigration reform, with Mexican cooperation. This is an enormously positive development for Mexico. We've been waiting for it for six years, and now we may get 'the whole enchilada.' ...I don't consider the border wall important compared to immigration reform. It was never going to happen anyway. It was just an electoral maneuver by the Republicans.

With Democrats running foreign affairs in the Senate, they may come up with a flexible interpretation of the Helms-Burton law that would allow the U.S., once Fidel dies, to negotiate and normalize relations with Raúl Castro....Cuba might agree to carry out economic reforms, free prisoners, improve human rights, and introduce decent labor laws, then hold free and fair elections. We have no idea if Raúl would do this, though."

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"Capital One never forced [them] to apply for any of their credit cards."

–Beau Wallace
College Station, Tex.

WHAT CAP ONE GETS RIGHT —AND WHERE IT GOES WRONG

"CAP ONE'S CREDIT TRAP" (News & Insights, Nov. 6) underemphasizes the benefits that companies like Capital One Financial Corp. bring to borrowers with poor credit. In the past, individuals with low income or sketchy borrowing histories were denied access to credit cards and deprived of an essential convenience. Through creative pricing and marketing approaches, credit-card companies have learned how to participate profitably in the low end of the market and in the process have lifted low-income households into the mainstream.

–Park Duncan
Greenwich, Conn.

UNLIKE MOST PROVIDERS of credit, which arbitrage their cost of capital against those of their borrowers, Capital One has profited for years from late and over-limit fees, also known as "nuisance fees," that it appears to generate at a prodigious rate.

In 2000, Richard D. Fairbank, chief executive of Capital One, stated that by not having raised its nuisance fees from $25 an incident to $29, as most of the company's competitors were doing the time, Capital One had forgone $ million of revenue.

The implications of that disclos were not flattering. If Capital One foregone $200 million in revenue a $4 hike in fees, it would suggest there were about 50 million incide in which the fee could have been rai Those 50 million incidents each ge ated a charge of "only" $25, bringing total of $1.25 billion. During the previ year Capital One earned under $600 lion, pretax, or less than half the inc generated by nuisance fees.

If Capital One were to cut the quency of incidents that generated by only 25% in that year, which, gi industry experience, was not unrea able, they would have cut their earni by 50%. When William Ryan sugge that Capital One earnings could be " astated" by a regulatory crackdow think he was being kind.

–Adam Hur
Calcine Managen
New

THE THOMPSONS' PROBLEM was inflicted. Capital One never forced

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THE ARCHITECTS OF TIME

couple to apply for any of their credit cards. It is the individual's financial responsibility to balance his or her own books and ensure that he or she is not overspending.

–Beau Wallace
College Station, Tex.

THE SAD THING IS that Capital One offers multiple credit cards to targeted customers because if they don't, their competition will. This practice is evidence of a business gone wild and is precisely why intelligent federal regulation is needed.

–Robert Carcich
Eatown, N.J.

TRUSTEES: WHAT CLIENTS AND BENEFICIARIES NEED TO CONSIDER

BUSINESSWEEK ASKS: "Can you trust your trustee?" (Personal Finance, Nov. 6). As president of Wachovia Trust, I can answer unequivocally: "Yes, you can!"

While it is the goal of every trustee to generate maximum returns for beneficiaries, it is important to remember that a trustee's first and foremost duty is to respect and follow the direction set by the client who originally placed their

PersonalFinance Legacies

Can You Trust Your Trustee?

trust in the trustee. Therefore, there are several points that I believe beneficiaries and potential trust clients should take into consideration.

Trusts are usually created by individuals seeking to have their investments managed by a professional investment manager under strict fiduciary standards, which create the highest level of duty for the manager to look out for the client's best interests.

Beneficiaries are sometimes disappointed at the instructions their parent or grandparent created for their inheritance. Beneficiaries often wish they could withdraw all of the assets that have been left to them as an inheritance, but trustees are usually directed to exercise discretion in distributing the assets at a pace that balances a beneficiar current and future needs.

It is important for beneficiaries have access to trustees. Today's bro geographic coverage of large banks l Wachovia enables clients to access th banks more easily than ever before. O er modern vehicles, such as Web si and trust centers, also provide compl and easy access to trust experts.

–W. Robert Nev
Presid
Wachovia Tr
Winston-Salem, N

YOUR GUIDANCE TO beneficiaries garding trustee performance failed mention a root cause of tension: multiple hats worn by trustees. T simplest way to assure that the perf mance and fees of asset managers be independently monitored is to independent trustees when structur family legacies.

Asset managers often serve as trus not because they are truly set up to so in a careful and thoughtful way because they want the money-mana ment role. In doing so, they essenti report to themselves, which is har

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recipe for happy beneficiaries in the ıg term.

–A.G. Newmyer III
Managing Director
U.S. Fiduciary Advisors
Palm Beach Gardens, Fla.

:RKSHIRE ISN'T PRICEY ›R THE VALUE IT DELIVERS

STRIKES ME as curious that you would casually refer to Berkshire Hathaway ares as "notoriously pricey" ("White ight of the week," The Business Week, ›v. 6). Although buying Berkshire does leed require a significant commitment capital for most investors, at 15 times nings it can hardly be considered pricey, much less notoriously so. Were Berkshire's share price to rise to, say, $420,000, giving it a multiple equal to Google Inc.'s, words like pricey might conceivably come into play—though I'm sure some Berkshire aficionados (and certainly die-hard Google fans) would disagree even then.

–Andy Obermueller
Amarillo, Tex.

CORRECTIONS & CLARIFICATIONS

'Now that's commuter power" (Up Front, Nov. 13) miscalculated the amount of energy produced daily by commuters in an energy experiment in a Tokyo train station. t should have said that each commuter generates 100 milliwatt-seconds of energy and that 70 kilowatt-seconds of energy would light a 100-watt bulb for more than .0 minutes.

WHY THE ROLES OF CEO AND CHAIRMAN ARE BETTER OFF APART

SPLITTING THE ROLES of chairman and CEO is sensible if you seek good governance ("A dangerous division of labor," Ideas: The Welch Way, Nov. 6). The tasks are different: The board oversees, and management manages. Each needs its own leader, and each leader needs to respect the limits of each job.

–Ira Millstein
New York

THE WELCHES MADE a strong pitch for having one person as chairman and CEO. But they attach a condition that is rarely fulfilled: Outside directors should talk to people inside and outside the company to find out what the reality is when it comes to top-management performance. When that happens, it doesn't make much difference if the jobs are split. Unfortunately, many outside directors do not have the time for such visits, and many executive directors do not accept such contacts outside their control. The Welches' recommendation would make a huge difference in reducing reputational risk and increasing the contribution of outside directors.

–Laurens van den Muyzenberg
Cannes, France

How to reach *BusinessWeek*

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Tech&You

BY STEPHEN H. WILDSTROM

Elbowing into Q Territory

When Motorola's Q smart phone made its debut early this year, it set a new standard for slim and hip. Users praised its full "qwerty" keyboard and PDA capabilities. The Q is a bargain at $99 after rebates with a two-year service contract. But you can get it only through Verizon Wireless—prompting other handset makers to produce similarly slim "Q killers."

Two of the latest examples are the Nokia E62 from Cingular and the Dash from T-Mobile, both American versions of phones that have been available in Europe and elsewhere for a while. As with the Q, the designs and prices will be attractive to consumers and professionals, but the two phones have different strengths and weaknesses.

THE NOKIA E62

The E62 costs as little as $99 after rebates with a two-year contract, plus $35 per month to add unlimited data. It runs Symbian, an operating system more popular in Europe than in North America. For good and bad, the phone's features resemble those of Windows Mobile Smartphones. The E62 has the ability to sync contacts and calendar with Microsoft Outlook, but like Smartphones, it has no touch-sensitive screen.

The design is unusual. The phone is a wedge-shaped rectangle, about 3/4 in. thick at the top end and tapering to less than half an inch. It's about a quarter-inch wider than the Q, just enough to make it a little hard to use one-handed.

THE E62 CAN CONNECT TO STANDARD Internet mail accounts. More endearing to many corporate or government users, it can connect with corporate mail systems that run BlackBerry Enterprise Server or Good Messaging (formerly called GoodLink) Service, from Good Technology, which is being acquired by Motorola. I tried out both mail systems on the E62. Good Messaging worked exactly as it does on Windows Mobile devices and Palm Treos. But running Research In Motion's BlackBerry Connect software felt nothing like using a real BlackBerry. In addition to being a bit clumsy and very slow in opening messages, the software syncs only mail and calendar, not contacts or any custom applications.

The E62 is a little light in the fun department. There are far fewer third-party programs available for Symbian than for either Windows Mobile or Palm OS. And at a time when at least a 1.3-megapixel camera is standard on phones, including the newest BlackBerry, the E62 has none.

The Dash is a more expensive proposition: $199 after rebates with a two-year contract, and an additional $30 per month for unlimited data, including access to T-Mobile "hot spots" using Wi-Fi. The whole experience i much more Q-like because the phone runs the same Windows Mobile 5.0 Phone Editi software. And the Dash is even narrower and shorter than the Q, providing the most comfortable one-handed operation I have seen in a phone with a full keyboard.

The biggest draw of the Dash, which is s by various carriers around the world under different names, is that it works both on T-Mobile's cell network and on Wi-Fi. This is hardly unique in Europe or Asia. The Nokia E61, a near-twin of the E62 that is sold in th rest of the world, also offers Wi-Fi in most markets outside the U.S.

Two worthy rivals to the hip Motorola smart phone, with a few caveats

The two varieties of wireless not well integrated: You have to choose one or the other manual Still, it's pretty easy to connect t Dash to Wi-Fi networks. And on you have done so, it's much eas to read Web pages, download e-mail, and perform the data-intensive job of synchronizing mail and calendar entries with a corporate Microsoft Exchange server. Keep in mind that T-Mob does not support either Good or BlackBerry Connect on the Dash.

Both the E62 and Dash are worthy additions to the full-keyboard smart-phone field. But I suspect my favorite sub-$200 product will be the Treo 680, due before yearend fro Cingular. It's an updated and cheaper version of the Treo 6 While it's a good bit bigger than either of these new entrie runs on the trusty Palm software that, for my money, rema the ease-of-use champ. ■

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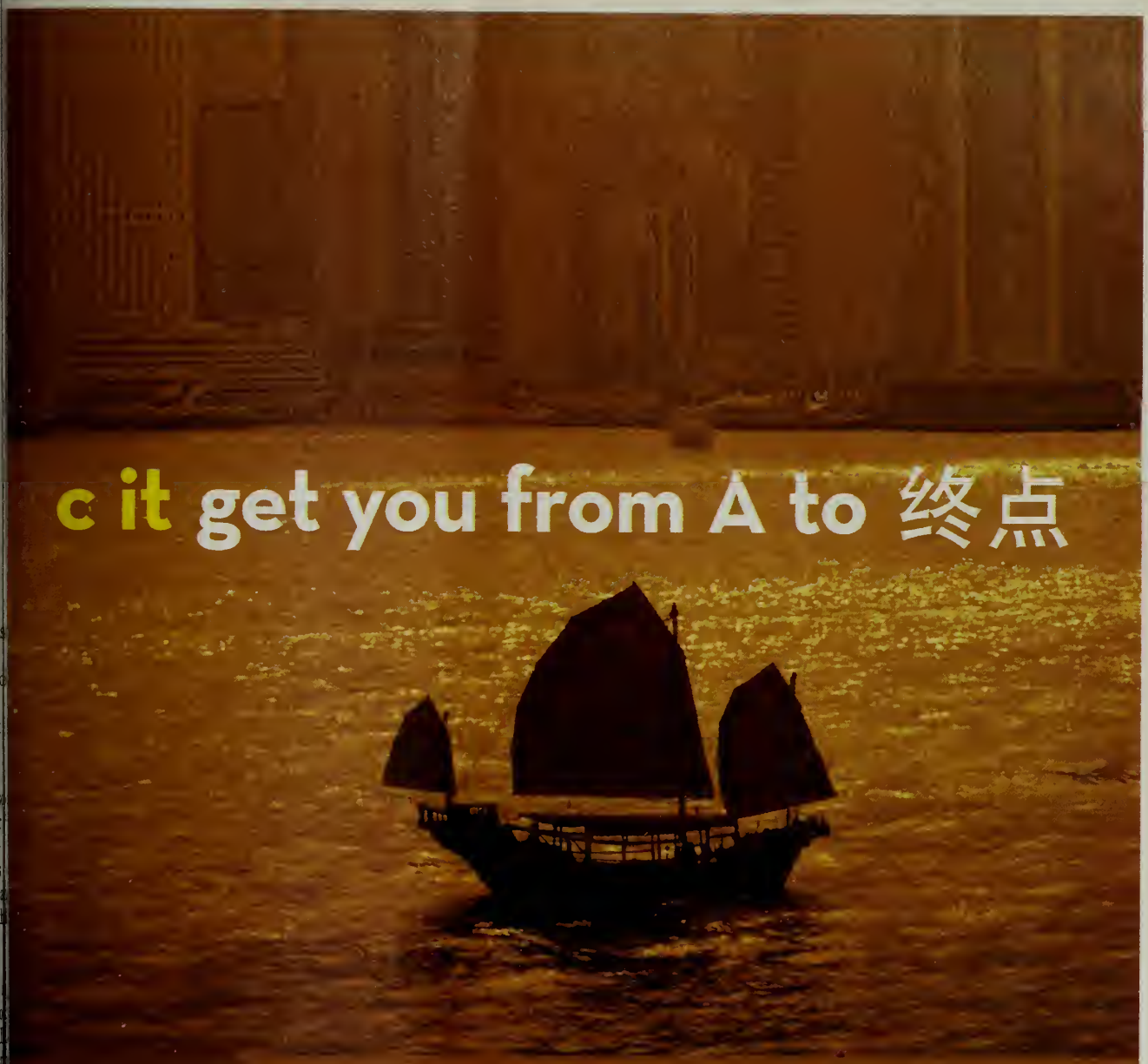

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MediaCentric

BY JON FINE

Now, an Ad from Our Networ

NBC Universal: ad agency. Or it will be, sort of. Its new digital czar, Beth Comstock, and her staffers are approaching key advertisers with a simple yet far-reaching proposition: Let our digital studios create some advertising for you. In other words, although NBC executives chafe at thi characterization, join with us to demolish long-standing notions of what

separates media companies from ad agencies. "The next natural place to use the talents of the studio is with marketers and advertisers," says George Kliavkoff, NBC Universal's chief digital officer. As Comstock conceded at a recent international TV conference, everyone must "get used to the idea that the media marketplace will be full of contradictions and tensions."

One big tension: A direct relationship between networks and marketers could threaten ad agencies' middleman role. Comstock is quick to point out that NBC's marketing efforts will primarily be "adjuncts" to existing campaigns and that "most of the discussions" with marketers involve ad agencies. Still, says one executive familiar with the discussions, in a world of product placement and digital short films built around products, what's message and what's content "starts to become all the same.... That's one of the things Beth Comstock is sitting there recognizing."

THESE DISCUSSIONS HAVE BEEN going on for about three months, Comstock says, and the first deals could be done in a month. The unit working with advertisers is a yearling production outfit called NBC Universal Digital Studios. Kliavkoff says its work is likely to appear outside company properties, perhaps on mobile devices or advertisers' own Web sites, and that it won't just be video. Also on tap: "casual games that can be associated with a particular brand."

Perhaps the toughest obstacles are internal. Even by the low standards set by modern media conglomerates, NBC Universal is "the hardest to work with" on ambitious marketing plays, says one key ad agency executive (who still applauds NBC Universal for its new clothes). There are fault lines within such behemoth organizations, and what works for the larger company may not be good for specific departments or salespeople. Various forms of big-company inertia have made mud of past attempts to try broad-gauged marketing moves. (The failed synergies of AOL Time Warner and Tribune Co. leap to mind.) One rea a newish digital studio leads this charg The fewer the dog years, the greater th likelihood of learning a new trick.

While it's a first for a Big Three netw NBC's move to produce advertising is r entirely unique. This spring, Viacom's Nick@Nite, Procter & Gamble's deodo Febreze, and agency Starcom MediaVe teamed up to produce 90-second sitco including an extremely miniaturized commercial break—featuring talking d called *The Poocharellis*. These aired for nine weeks at precisely 9:57 p.m. easte time. But Viacom does not own anythi like NBC, nor is Viacom's institutional gravitas anchored by a news department that must mainta an ironclad divide between ad and programming. (No, Com Central's *The Daily Show with Stewart* does not count as new

NBC blurs the lines between broadcaster, ad agency, and marketer

Nothing next-generational at a broadcast net arises in a vacuum. NBC still trails ABC a CBS. In October, NBC Univers announced pending cost and cuts and signaled a tighter fo on cheaper fare like game sho and reality TV for the first hou of prime time. About 40 news staffers were just laid off. Tl company's latest moves won't quickly turn around NBC, b its new dances with advertisers rejigger the entire notion what a network is and how it participates in marketing. A the ad agencies now feeling the tectonic plates rumble an fear rising, well, nothing is stopping you guys from makin like networks and creating your own programming, as so of the smart agencies have done for some time. ■

BusinessWeek.com For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia.

JAMES C. COOPER

Exports Are Giving The Economy a Surprise Lift

ıey're on a tear—helping to offset the housing recession

U.S. ECONOMY The three pillars of U.S. economic growth this year ıve been consumer spending, business outlays for new buildings and ıuipment, and exports. They have supported the economy strongly rough $70-per-barrel oil, $3-per-gallon gasoline, interest rate hikes, ıd a housing recession. Each pillar was crucial, yet demand by U.S. sumers and businesses tends to get most of the ntion, while foreign demand often gets pushed into background. It shouldn't be. As globalization opens ver-wider array of opportunities, U.S. exports are ing an essential role in powering overall output, oloyment, and profits.

ust look at the latest report on U.S. international le. Most of the notice, as usual, was on the import of the balance. The impact of cheaper oil on overall orts helped to narrow the monthly trade gap to .3 billion in September from $69 billion the previous ıth, one of the largest declines on record. Receiving attention: Exports are on a tear this year. Overseas ments of goods and services in September posted a d 0.5% increase from August, and they are up 15.8% n a year ago.

xports of goods, which comprise 70% of foreign ments, have been especially strong. Real exports of ds, which are adjusted for price changes, jumped 6 from August and have grown 15.7% from a year —the fastest annual growth rate in nine years. The ıs have been broad, spanning product sectors and graphic regions. Shipments to European and Pacific countries have accelerated sharply over the past , and capital goods continue to lead the gains.

ENORMOUS THRUST EXPORTS have provided conomic growth is somewhat hidden in the gross estic product data. That's because foreign trade's ribution to GDP is the net of exports minus imports. balance, the widening trade deficit has subtracted growth. But take a look at only the export side of the er. Shipments abroad added 0.7 percentage points ıe economy's 3.2% growth rate in 2005, and the fillip been even greater this year. In fact, so far in 2006, orts have contributed as much to GDP growth as tal spending by businesses.

ı addition, note that exports are accounting for an -larger share of overall U.S. output. After falling ng the global downturn earlier in the decade, the e of total production of goods being shipped abroad surged to a record 17.6% as of the third quarter, up from a low of 13.7% only three years ago (chart).

That greater share is a by-product of globalization, which is also evident in the accelerating volume of U.S. trade—exports plus imports—over the past three years. It also shows up in the increasing percentage of profits of U.S.-based corporations that is coming from their overseas operations. During the same three years, that share of corporate receipts has averaged 25.3%, up from 18.3% in 1998. Although there are no official data, it's a good bet export-related profits are making a greater contribution to the bottom line as well.

THE BENEFITS OF STRONG foreign demand are providing an especially important source of support to the economy right now as the housing downturn takes its biggest bite out of growth. U.S. manufacturing is the key beneficiary. Domestic demand for factory goods has slipped, reflecting the softness in construction supplies and the recent cutbacks in the auto industry. The weakness in both of these areas has put a drag on industrial output and jobs in recent months, but exports have helped to keep factories humming at high rates of capacity utilization.

A BIGGER ROLE IN THE ECONOMY

Data: Bureau of Economic Analysis, Global Insight Inc.

Exports are almost certain to continue to grow strongly in the coming year, and it's easy to see why. In the very near term, for example, the index of export orders in the industrial sector compiled by the Institute for Supply Management posted a big rise in October to its highest level since January.

Further ahead, and more fundamentally, favorable economic and financial forces are in place to keep economies overseas growing strongly in the coming year. Although interest rates outside the U.S. continue to rise, most notably in the euro zone, global financial conditions remain relatively easy and support growth. In both the

euro zone and Japan, for example, the central banks' inflation-adjusted policy rates remain well below those in America. Also, the narrow difference between yields on government and corporate bonds indicates that global credit markets see little risk in lending, suggesting a climate that will accommodate borrowing.

WHAT'S DIFFERENT ABOUT GROWTH outside the U.S. now, compared with past business cycles, is that it is being driven more by homegrown demand and less by exports, especially to America. That independence will give foreign growth more staying power as the U.S. economy slows. Earlier upswings overseas, such as Germany's and Japan's in the late '90s, were cut short precisely because export growth slowed and those countries lacked solid domestic demand to fall back on.

This time, although third-quarter growth in the euro zone slowed to a 2.1% annual rate after averaging a strong 3.5% clip in the first half, both Europe and Japan still boast solid corporate sectors, improving labor markets, and healthy financial markets. Much the same is true across the Pacific Rim. As a result, U.S. exports to Europe in the third quarter are up 20.7% over the past year, the fastest annual growth rate in more than a decade. The increase to all Pacific Rim countries has nearly doubled, to 15.2% from 8.7% last year. Those two regions account for about half of all U.S. exports, and other areas show strong growth as well (table).

In addition, energy-importing economies worldwide will benefit from the dip in oil prices in ways that will do even more to bolster demand at home. Cheaper energy will lower production costs, helping to shore up profits will lift the confidence of businesses and consumers ar cut overall inflation, boosting the purchasing power of consumers' incomes.

The other reason to expect further gains in U.S. exports is the dollar's decline. Its dip seems likely to continue given the still-yawning American trade deficit and the narrowing spread between U.S. and forei short-term interest rat That tighter spread tends to decrease the attractiveness of dollar based securities as investments.

DEMAND PICKS UP AROUND THE GLOBE

THIRD-QUARTER GROWTH IN U.S. EXPORTS
PERCENT CHANGE FROM A YEAR AGO

	2005	2006
CANADA	10.2%	9.4%
MEXICO	8.0	9.9
EUROPE	8.2	20.7
PACIFIC RIM	8.7	15.2
LATIN AMERICA	20.0	25.7

Data: U.S. Census Bureau, Global Insight Inc.

From its peak in ear 2002 through October the real trade-weighte dollar has dropped 14.3%, and it fell further against m currencies in November. In particular, the greenback h grudgingly but steadily made competitive gains again the Chinese yuan as China continues its baby steps toward greater currency flexibility.

Clearly, globalization creates both challenges and opportunities. The emergence of greater U.S. competitiveness in a growing world economy is one opportunity that many American exporters are taking advantage of. And the timing is especially favorable—when the economy can use the extra support. ■

PRODUCER PRICES

Extra Pocket Change for Business

BUSINESSES ARE getting some relief from cost pressures as gains in prices for materials, supplies, and other goods decelerate. And the break they're getting extends beyond energy products, which should provide some comfort as companies face higher labor costs and softer economic conditions.

Producer prices for finished goods outside of food and energy fell 0.9% in October, led by a big drop in the price of cars and trucks. The overall index posted a 1.6% drop, reflecting another plunge in energy prices. The October data verified what earlier national business activity reports found: More companies are reporting easing cost pressures.

COMPANIES FACE EASING PRICE PRESSURES

*FINISHED GOODS LESS FOOD AND ENERGY
Data: Bureau of Labor Statistics, Global Insight Inc.

The trend should continue. Prices for goods at earlier stages of production also moderated: Core prices for semifinished goods were unchanged from September, and crude materials fell 1.3%. A pileup in business inventories will help to keep a lid on prices, especially in areas such as vehicles, tech equipment, and housing-related goods, all sectors where stockpiles have risen more than desired in recent months. Companies are also seeing a little relief from abroad, with the prices of imported goods (excluding energy) posting their first monthly decline in nearly a year.

The slowdown in producer pric comes at an important time: Risin labor costs are putting increasing pressure on U.S. businesses' profit margins. To be sure, softer prices for supplies and materials will not fully offset higher labor costs, whi account for about 75% of all busin expenses in the service sector and more than 50% at factories, says Joshua Shapiro, chief U.S. econom at economic consulting firm Maria Fiorini Ramirez Inc.

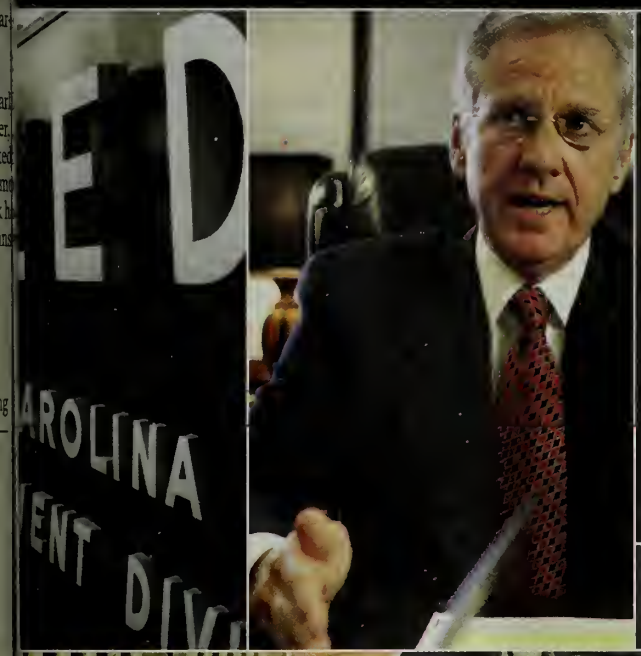
But cooler prices for goods mea one less worry for businesses—an justification for the Federal Reserv The trend appears to back up the central bank's forecast that a slow pace of growth in the second half the year will lead to easing inflatio pressures at the consumer level. T would allow the Fed to keep intere rates steady for a while longer. ■

–By James Mehring in New

Hitachi | true stories

A NEW BREED OF BLOODHOUND

The True Story of the South Carolina Computer Crime Center



After the warrants are issued, the suspects picked up, and the computers seized, the real detective work begins at the South Carolina Computer Crime Center. And it's powered by Hitachi storage systems.

Learn how South Carolina's new computer bloodhound is helping law enforcement track down cyber criminals nationwide.

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Hitachi | true stories

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Wooing Delta You have to give **Doug Parker** credit: He doesn't give up easily. The **US Airways CEO** on Nov. 15 offered $8 billion for bankrupt **Delta Air Lines,** a 25% premium over the company's market value. Parker proposed a merger last spring but was rejected by Delta **CEO Gerald Grinstein.** This time he's going directly to Delta's creditors. Grinstein said Delta would ponder the idea but in the meantime would proceed with its efforts to emerge from bankruptcy as a standalone airline.

See "Now boarding: merger mania," page 36

Birth of a Bourse? Just as the **New York Stock Exchange** draws nearer to buying **Euronext,** the big European exchange, a fearsome rival is taking shape. On Nov. 15, **Goldman Sachs** and six other investment banks said they plan to build a pan-European "multilateral trading platform" that promises sharply lower trading costs by the end of 2007. Code-named **Turquoise,** it will be a computerized system, a bank source says. Such systems shook up trading in the U.S. in recent years but won't be legal in Europe until next year. Turquoise is bad news for established bourses such as Euronext and the **London Stock Exchange,** 25% owned by **NASDAQ.** They'll have to either lower costs to keep the new player at bay, a chore since big investment banks claim half the volume in European equities trading, or contemplate extinction. No wonder **Deutsche Börse** dropped out of the fight for Euronext on Nov. 15.

ONLINE *See "Hot in pursuit of Europe's exchanges," www.businessweek.com/go/tbw*

Private Equity Goes Hunting Media... The me buyout pot keeps bubbling. *The New York Times* rep that radio behemoth **Clear Channel** is mulling bids in the billion range (plus $8 billion in assumed debt) from private equity groups. Meanwhile, **Tribune Co.'s** slow semi-public weighing of its options won at least preli nary attention from **Gannett,** according to the *Chicago bune,* and from a seeming cast of a thousand local mog and other companies coveting its individual papers fr Los Angeles to Baltimore. The Tribune board is expecte unveil a winner, or winners, by yearend.

...And Apparel Outfits It's not even Thanksgiving, **Eddie Bauer** is running a juicy sale. The 267-store Ba clothing chain, a year removed from being spun off dur Spiegel's bankruptcy, on Nov. 13 tried on and liked a $ million cash offer from two private equity firms. Th nearly a 5% hike over its still struggling stock. Shrink sales and too-tight margins also may prompt **Timberlan** sell itself, *The Wall Street Journal* reported on Nov. 14.

Dell Delays The world's biggest computer maker, wh has been the subject of an informal **SEC** inquiry, announ on Nov. 15 that the investigation has been elevated formal one. Dell also said it would delay reporting th quarter earnings because of "the level of complexity company is facing in the preparation of its prelimin results." It hasn't yet given regulators second-qua numbers, either.

PS3 Problems It wasn't the PR bonanza **Sony** hoped At the **PlayStation 3's** long-postponed Nov. 11 debut in Ja a scarcity of the machines created chaos at retailers. D later, Sony confirmed that not all games designed for pr ous Sony consoles are compatible with the new box, as been promised. Sony blamed the PS3's more sophistic software and said the glitches will plague machines in the U.S. Analysts say some developers may hold off release of PS3 games until conditions improve.

ONLINE *See "Sony's PS3 issues threaten reviv www.businessweek.com/go/*

IBM, Banker? **Citigroup** may have finally bagged Chinese prey. *The Wall Street Journal* said on Nov. 15 a Citi-led consortium would get the nod as the prefe bidder for **Guangdong Development Bank,** which Citi been pursuing for more than a year. Also expecte be on the team: **IBM,** which would get a 5% stake in troubled state lender. That would give Big Blue a leg in snagging contracts to help the bank upgrade its IT work—and a shot at work for other banks in need of as the sector opens up to foreign competition in Dec ber. If the deal goes through, Citi will pay $3.1 billion 85% of Guangdong.

Boeing Cruises Boeing's big-jet fortunes fly ever hig Company sources said on Nov. 15 that **General Elec**

mmercial Aviation Services leasing and finance unit, **GECAS,** ans to announce the purchase of 15 777 jetliners. The al, valued at $3.5 billion at list prices, is likely to be the st wave of lucrative widebody orders that may fall to the anemaker in coming months, dropping an additional 0 billion into Boeing's cockpit as it capitalizes on the sedive of European archrival **Airbus. British Airways, Korean , Vietnam Airlines, Philippine Airlines,** and **Lufthansa** all want eing's big jets in the near future.

T Hangs Up on Ricke **Deutsche Telekom** on Nov. 12 sted **Chief Executive Kai-Uwe Ricke** and the next day named close protégé, **T-Mobile** chief **Rene Obermann,** to take over. w boss same as old boss? Not necessarily. Obermann co-eated the strategy that has failed to stem the loss of Ger-an market share. But shareholders hope the aggressive -year-old, who quit college to start his own mobile-phone ovider, can push change faster than Ricke. Obermann's ggest obstacle may be cutting costs. The German state, a % shareholder, won't countenance massive layoffs.

ONLINE *See "Deutsche Telekom: Obermann's Challenge," www.businessweek.com/go/tbw*

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ussia and the WTO Welcome to the club. That's the essage **President George W. Bush** will give **Vladimir Putin** on v. 18 when the two meet in Hanoi to sign an accord that ens the door to Russian membership in the **World Trade ganization.** Moscow started membership talks 13 years ago, d the deal with Washington removes the last remaining rdle to entry, now expected within six months. Bush, wever, was embarrassed on the eve of his departure by use Republican leaders, who yanked a bill liberalizing de with Vietnam, thus clouding its prospects.

Exit of the Week

ne of the highest-paid executives in homebuilding nds himself homeless. **Bruce Karatz,** longtime CEO of os Angeles-based **KB Home,** on Nov. 12 fell prey to the tock options scandal. An internal investigation found at Karatz and another exec handed out options back-ated to days when the stock was cheap in order to make em more valuable. The moves cost the company up to $50 million in additional compen-sation over seven years ending in 2005. Karatz has agreed to pay back $13 million. He was replaced as CEO by **Jeffrey Mezger,** a 13-year KB veteran not involved in the backdat-ing. The board is searching for an outsider to serve as chairman. Con-sidered a creative marketer in an industry known for cookie-cutter omes, Karatz unveiled a successful design partnership ith **Martha Stewart** earlier this year. He made more than 155 million in 2005, most of it from cashing in options.

RUCE KARATZ

ONLINE *See "KB Home cleans house," www.businessweek.com/go/tbw*

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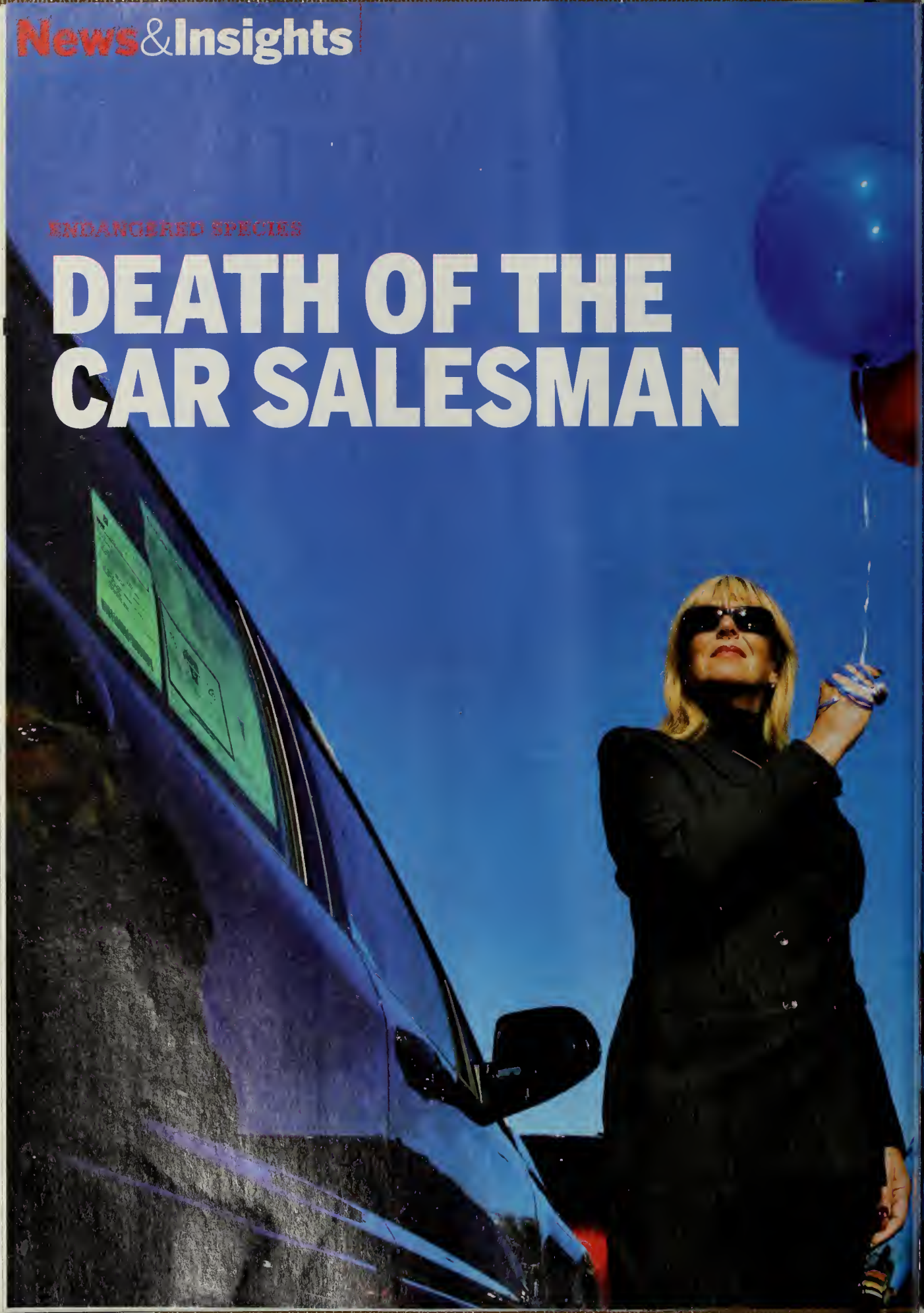
ENDANGERED SPECIES

DEATH OF THE CAR SALESMAN



NO PARTY Cerani figures her income will be off by almost $15,000 this year

JAY L. CLENDENIN/POLARIS

Savvy customers, lower margins, fewer sales, and too many dealers: Car salespeople never had it so bad

BY DAVID WELCH

MARY CERANI HAS been selling Pontiacs and GMCs in Wilmington, Del., for seven years. She is one of Union Park Pontiac's top salespeople. Rather than alienating buyers with the hard sell, she listens and finds what customers want. That approach, not to mention a congenitally upbeat attitude, wins her plenty of referrals.

Her sunny disposition wasn't much help, though, when a customer showed up recently looking for a Pontiac G6. The man proved difficult the moment he called the dealership, Cerani recalls. He didn't believe the sedan got 27 miles per gallon, as advertised. He wanted interior wood trim and special wheels—a custom order. And after taking delivery of the car, he said he didn't like the ride. Although mechanics could find nothing wrong, Cerani got him a replacement.

When the guy finally drove off the lot, Cerani tallied up the time spent: at least 12 hours, she figured, over many weeks. Then she calculated her commission: $100, or $8 an hour, $1.85 more than the state minimum wage. "Fortunately, my husband works," says Cerani, who is 51 and has two grown children. "If I had no other income, it would be very hard."

So it goes at auto dealerships from Wilmington to Walla Walla. Car sales staff get about as much sympathy as personal injury lawyers, it's true. But these days it's a tough way to make a living. The outsize commissions, small-town clout, and country club lifestyle are as dead as Oldsmobile (unless you're sell-

SIZING IT UP
Thanks to the Web, buyers know what cars cost

JEFFERY SALTER/REDUX

ing Lexuses or BMWs). Brutal competition has driven down dealer profit margins and sales commissions. Meanwhile, customers armed with Web-harvested price information have all but erased the salesman's tactical advantage.

Making matters worse, there are too many dealers out there. If normal economic rules applied, say industry insiders, the nation's dealer population of 21,000 (three-quarters of them Big Three stores) would be cut by at least 3,000. But state franchise laws prohibit manufacturers from winnowing their retail ranks, giving court protection to mom-and-pop businesses that might have vanished years ago. The fastest way to cut franchises is to pay them compensation—a multimillion-dollar payout that the Not-So-Big Three can ill afford nowadays.

So even as Detroit's shrinking carmakers shutter plants, big dealers like AutoNation Chairman and CEO Mike J. Jackson say the automakers have many metro stores they don't need. And as Ford, General Motors, and Chrysler try to reignite passion for their vehicles, they're losing much of their front-line force. Many salespeople are fleeing to more hospitable climes, including import stores. "I'm seeing a migration of capital and talent away from domestic dealerships that I have never seen before," says Jackson. "It has reached a tipping point in the last year."

Not so long ago selling cars was one of the best ways to make a living without a college degree. Talk to a car-lot veteran, and chances are he'll rhapsodize about the go-go 1980s, when earning $100,000 a year wasn't uncommon and tooling around in Cadillacs and Porsches de rigueur. The hours were long, but thos willing to work into the evening wer richly rewarded. At some dealership cash bonuses were handed out ever day—and often spent that night at loc hot spots. Bert Sadler was 19 when he be gan selling Lincolns in the '80s. "I mad $7,500 my first month," says Sadler, wh until recently ran a Ford store in Wichit "I had a pretty wild lifestyle. The life of car salesman was glamorous."

It didn't hurt that the sales force hel most of the cards. Since buyers didn know what cars really cost, dealers coul pad them with all kinds of options an keep thousands of dollars in marku Unscrupulous salesmen did just abou anything to close a deal. One trick was say the dealer had misplaced the keys the trade-in. While someone "looked" fo the keys, the hard sell went on and on.

BUYER'S REVENGE

THE CAR SALESMAN became one the most derided of American arch types—and provided rich fodder for fi tion and film. Think Harry Angstrom, th adulterous Toyota-selling protagonist John Updike's *Rabbit* books. Or Jer Lundegaard, the slimy Oldsmobile deal played by William H. Macy in *Fargo,* wh in one scene sneaks in a weatherpro sealant to jack up the price.

Now consumers are getting their r venge. By spending half an hour on sit like Edmunds.com, buyers can find ho much the dealer paid for the car, the co of options, what consumers are paying a specific region, and which models a

GENERAL MOTORS

Stuck in the Slow Lane in Japan

BY IAN ROWLEY

Selling American cars to Americans has never been harder. Even so, not many U.S. auto executives would want to switch places with Antonio Zara. In April, the 40-year-old Philippine native took over one of General Motors Corp.'s toughest jobs: president of vehicle sales for Japan, a country where U.S. nameplates have less than 1% of the market.

The challenge can't be overstated. GM peaked in Japan in 1996, when it sold 71,495 cars. Through September of this year, America's No. 1 carmaker sold just 9,762 Cadillacs, Saabs, Chevrolets, and Hummers in Japan—15 models in all. Toyota Motor Corp.'s Japanese sales during the same period? More than 1.3 million. "I knew Japan was tough," says Zara, who left a job at Toyota in 1999 to join GM because he thought he would have an easier time climbing the ranks at the U.S. company.

Stand outside foreign car importer Yanase's flagship GM dealership in Tokyo's Shibaura district, and the size of the task is quickly apparent. Traffic inside the GM showroom is noticeably sparser than at the Mercedes-Benz dealership, which Yanase operates next door. Yet GM's heavy metal once turned heads on the streets of Tokyo. In the 1950s, Emperor Hirohito was chauffeured around in a Cadillac Series 75 limo. GM brands "were once a symbol of th American dream and the heartthrob car fo the Japanese," says Hiroyuki Furuichi, CEO Yanase. And in the late '90s, Toyota sold al 20,000 Chevy Cavaliers in Japan in a deal that was put in place to ease trade friction before the venture fizzled out. "Even with a stronger dealer network, we weren't able t sell the cars," says Mitsuo Kinoshita, a Toy executive vice-president.

GM isn't alone in finding the Japanese tough to please. Detroit's share of import

vailable at various dealerships. Many onsumers start negotiations citing the nvoice price—what the dealer paid—and ffer a few hundred bucks over that.

And when dealers are crowded into a ree- or four-mile radius, it's only natural r buyers to play one store against another: ustomers routinely show up with bid pric- s from crosstown dealers in hand. When lichael Logue, a 42-year-old software sup- ort specialist for IBM, bought a Ford Focus ecently, he shopped four dealers in the enver area before finding the right car the right price. "There's a generation of eople who don't like buying cars," says ogue. "To have all of this information on our desktop is huge."

If assertive customers aren't challenge nough, the automakers have cut sticker rices. That makes sense for manufactur- s, which are trying to get sticker prices oser to what people really pay. It gives uyers a better way to compare Ford GM cars to the competition, whose ickers more closely match transaction rices. But the move has whacked dealer arkups by as much as 30%, putting ore pressure on commissions.

Add it all up, and the arithmetic starts look pretty dire for a car salesman. Say vehicle sells for $20,000. Since a typical arkup on a lower-priced domestic car is out 8%-9%, the dealership has $1,800 negotiate away to the customer, pay r overhead, advertising, maintenance osts, and sales commissions. If the buyer egotiates away half the markup and the ealership keeps $300 for its costs, the alesperson takes 20% of the $500 that's left. That's a $100 commission.

Chump Change On the Lot

Once the negotiating's done, there's not much left

VEHICLE PRICE	$20,000
DEALER MARKUP	$1,800
– $300 OVERHEAD	= $1,500
– $1,000 CUSTOMER DISCOUNT	= $500
X 20% COMMISSION	= $100

Data: *BusinessWeek*

Honda, Toyota, and Nissan dealerships are getting hit, too, although the damage is often less severe. At Metroplex Toyota, south of Dallas, Wesley Rust has watched his income fall from $140,000 in 1999 to $94,000 this year, despite selling the same number of cars. He says the markup on a Yaris subcompact is $339. He recently spent four hours selling one and made a commission of $84. "I don't care if I sell this car or not," says Rust. "I don't even want to sell it."

The squeeze is hurting Big Three dealers the most. Ford, GM, and Chrysler stores sell an average of 500 to 600 cars a year. Compare that with 1,100 per year at Ford stores just five years ago. So even as commissions fall, salespeople are selling fewer cars. It's easy to see why Cerani figures her annual income will be down almost $15,000 this year, to no more than $50,000.

Is it any wonder Big Three salesmen are retiring or joining the competition? Paul Runkle sold American cars for 35 years in Greensburg, Pa. His father was a Ford dealer, and until last year he never sold anything but domestics. But when his income fell from $65,000 to less than $40,000, Runkle left the Pontiac-Buick store and joined a Honda dealer. He figures he'll get back above $60,000 in the first year. "If my father saw me," says Runkle, "he'd roll over in his grave."

In recent years thousands of travel agents have gone under in the face of online competition. While the franchise laws preclude such a far-reaching revolution in the car business, industry watchers expect the Web to play a larger role over time. Under one scenario, says Edmunds.com Inc. analyst Jesse Toprak, buyers would work out the numbers online, then visit the dealer, where a salaried customer service agent would arrange financing and close the deal.

That's a long way off. In the near term a wave of consolidation is more likely. Ford and GM are trying to get big, healthy dealers to buy weaker ones. Theoretically, those left would post bigger profits and pay better wages. Mark LaNeve, GM's marketing chief, insists "the good dealers and sales people are making money." In some cases, yes, but until the shakeout comes, Cerani and her kind will continue to struggle—or get out of the car-selling business for good. ■

GM is "capable of surprising people"

PETER BLAKELY/REDUX

es in Japan dropped to 6.4% in the six nths to September, down from 15.8% a ade ago, once you factor out acquired ign brands like Land Rover. Chrysler up sales slumped to 6,990 cars last year. And a full three-quarters of the 26,000 cars Ford Motor Co. unloaded were European brands such as Jaguar and Volvo.

It doesn't help that the market is shrinking as Japan's population declines and drivers hold on to their cars longer. But U.S. automakers have also been dented by the perception of poor gas mileage and lingering questions about quality, despite surveys that show U.S. brands catching up to the likes of Toyota. "Sins of years past continue to dog them," says Christopher Richter, an analyst at brokerage CLSA Asia Pacific Markets.

Some of GM's woes are self-inflicted. To raise cash, it has sold or scaled back stakes in local manufacturers Suzuki, Isuzu, and Subaru parent Fuji Heavy Industries—a move that has further battered morale at GM's 59 Japanese dealers. It also has stopped importing low-margin Opels from Europe this year, which will hurt sales. And GM might suffer from its decision not to adapt the revamped Chevy Camaro muscle car, once popular in Japan, because meeting local safety standards is so expensive.

Despite GM's puny sales, Zara says the market is worth fighting for. One reason is that GM can charge premium prices. The Cadillac XLR luxury roadster, the most expensive model in GM's Japanese lineup, goes for $100,000, about 25% more than in the U.S. Indeed, GM's Japan operation continues to turn a profit—enough to keep Zara looking on the bright side. "We are capable of surprising people," he says.

–With Hiroko Tashiro in Tokyo

TAKE OFF Delta's high-margin global routes would boost US Airways

AIRLINES

NOW BOARDING: MERGER MANIA

US Airways' bid for Delta may signal the beginning of widespread consolidation

BY DEAN FOUST

FOR MORE THAN A DECADE, analysts have predicted a massive consolidation of the airline industry that would whittle the roughly 130 carriers now flying the U.S. skies to a smaller clutch of much bigger carriers. Among the many reasons consolidation hasn't happened are the complexities of merging disparate aircraft fleets, overlapping hubs, and the morale-sapping process of combining different unionized workforces.

But with US Airways Group's hostile $8 billion bid on Nov. 15 for bankrupt Delta Air Lines Inc., merger mania may finally occur. Most of the other so-called legacy carriers are out of bankruptcy, and analysts believe that US Airways' surprise bid will start a merger wave that would leave the legacies better able to compete against discounters like Southwest Airlines Co. and JetBlue Airways Corp. "The industry is fragmented and primed for consolidation," says Ray Neidl, an analyst for Calyon Securities in New York.

Analysts say that Delta's initial reluctance to enter bankruptcy may end up costing it its independence. Some rival carriers readily used Chapter 11 as a way to break unfavorable aircraft leases, dump pensions on the government, and renegotiate labor contracts that put them at a competitive disadvantage to the discounters. But Delta, which has long prided itself on its paternalism, held out until late 2005 in hopes of preserving its employee pensions. That put it a good year or two behind the restructuring efforts of rivals like US Airways and United, which are now reporting strong profits, and may have left Delta more vulnerable now that the industry's fortunes are improving. "They should have taken their medicine earlier," says Roger King, an analyst for CreditSights.

US Airways Chairman W. Douglas Parker' audacious bid for the much larger Delta would vault his airline from an industry also-ran to the nation's largest carrier by number of passengers. would also have the largest market sha in 155 of the nation's 420 airports. In a dition, snaring Delta would also give U Airways a stronger presence in Euro and South America—high-margin inte national routes that are largely immu from the discounters.

Big Sky

A tie-up of US Airways and Delta would create one of the biggest carriers in the world

DELTA		US AIRWAYS
$16 billion	2006 revenue*	$10 billion
47,000	Employees	35,000
4,067	Total daily flights	3,846
461	Total destinations	234
457	Aircraft	357

*Estimated **Data:** Company reports

A BETTER PLAN?

FOR DELTA, HOWEVER, the overtu comes at an inopportune time. Its mana ers have been telling creditors and the own board that the airline's growth pote tial as a standalone entity would yield be ter returns than what creditors would r ceive from a competitor's bid. "If we clo the revenue gap [with other airlines], will be the most profitable airline in t industry," Delta Chief Operating Offic James M. Whitehurst said recently.

Will creditors buy that logic? Clark C sky, a high-yield analyst with KDP Inve ment Advisors in Montpelier, Vt., says th Delta's creditors will "put a lot of pressu on management to prove their plan is b ter." San Francisco aviation cons tant Michael Roach points out th the bid is a 25% premium above t level at which Delta's unsecur debt recently traded.

Parker's may not be the final b Facing the prospect of a bulked- Delta, analysts believe that oth carriers might feel they have choice but to strike deals of th own before the most attractive pa ners are spoken for. "You do want to be left out when the mu stops," says Robert W. Mann Jr. New York-based airline consulta United might counter with a Delta bid its own, or failing that, could try to co bine with Continental. If United make move, analysts expect American Airli or Continental to pursue Northwest A lines. Let the merger games begin. ■

–With Lorraine Woellert in Washing and Brian Grow in Atla

able programs (such as Microsoft Dynamics CRM Mobile 3.0), features, and functionality vary by device and Windows Mobile operating system. Connected devices, connectivity, ver-the-air synchronization solutions may require separately purchased equipment and/or other wireless products (e.g., Wi-Fi card, network software, server hardware, or ctor software). Service plans are required for Internet, Wi-Fi, and phone access. These products and services may need to be purchased separately. Features and performance ary by service provider and are subject to network limitations. See device manufacturer, service provider, and/or corporate IT department for details.

THE MINIMUM WAGE

MORE AMMO FOR A HIGHER MINIMUM

New research says a ripple effect would hike the pay of a lot of family breadwinners

HOUSTON An increase would help janitors whether their strike succeeds or not

BY PETER COY

IF YOU WANT TO PICK A FIGHT with a free-market economist, say something nice about the minimum wage. Democrats in Congress want to raise it next year. As they gear up, economists in the opposition are arguing that it will make unskilled workers too expensive to hire. They also say it's an inefficient way to help the working poor, since a lot of the people who make the minimum wage, now $5.15 an hour, are teenagers living at home.

But the economics profession is far less united against the minimum wage than it was a generation ago. Since the early 1990s an influential group of economists has poked holes in the once strongly held belief that the minimum wage is a major job killer. And now there's economic research disputing the rest of the conventional wisdom. Some economists are saying that minimum-wage increases have a ripple effect, bumping up the pay of a large portion of the working poor. If they are right, that would strengthen the political appeal of a minimum wage hike by increasing the number of potential voters who are helped.

If the minimum wage is raised to $7.25 an hour over the next two years, 6.6 million workers, or 5% of the workforce, would be directly affected. By itself that's not a very big number. But an additional 8.3 million will get "ripple effect raises," according to the Economic Policy Institute, a labor-supported Washington think tank. The ripple effect means employers tend to raise wages for workers who make above the new minimum, even though they have no legal obligation to do so. As a result, the Economic Policy Institute estimates that such a minimum wage increase would raise pay for 11% of the workforce. The impact might be even broader: Jeannette Wicks-Lim, a research fellow at the Political Economy Research Institute at the University of Massachusetts calculates that 16 of workers could get raises if the hike passed and goes into effect immediatel

The ripple effect tends to make minimum wage boost a better deal f the working poor. That's because t workers who are likely to get tho ripple effect raises, many of whom nc earn $8 or $9 an hour, are often t primary breadwinners in their famili The Economic Policy Institute estimat that while teenagers account for 29% those who would directly benefit fro a substantial increase in the minimu wage, teens account for only 14% the higher-paid workers who would g ripple effect raises.

There's no free lunch, of course: T existence of a ripple effect from t minimum wage hike also raises the to cost of the increase to employers. Indee opponents of a higher minimum wag such as economist David Neumark the University of California at Irvi are willing to concede that ripple fects exist—they just view them as potential negative rather than simply positive. If government intervention the labor market li the pay scale for mc workers, they say, th increases the odds job losses.

But other ecor mists, including Al B. Krueger of Prir eton University, say would take a minimum wage substanti ly higher than what's being contemplat to wipe out jobs. They say there's sca real-world evidence for harmful effe of the minimum wage hikes that have curred to date.

Out in the low-wage working wor certainly, it's hard to find much supp for the free-market arguments agains higher minimum wage. Concepción La deros, a 38-year-old Mexican immigra has spent five years cleaning bathrooms a Houston office bui ing for $5.25 an ho Sometimes she ca afford her $100 month diabetes me cine. Now she's strike for higher p more hours, and me cal benefits. If Congr passes a minim wage hike, she'll ge raise whether the str succeeds or not. And will workers earnin good bit more. ■

A BROADER BOOST THAN EXPECTED

Assuming the federal minimum wage rises to $7.25 an hour by early 2008, 14.9 million workers could benefit

INDIRECTLY* 8.3 MILLION

DIRECTLY 6.6 MILLION

*NONMANDATED PAY INCREASES TO WORKERS EARNING ABOVE THE NEW MINIMUM WAGE

Data: Economic Policy Institute

5.30% APY

ONE YEAR CD[1]

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COMMENTARY

BY DAVID HENRY

London's Freewheeling Exchange

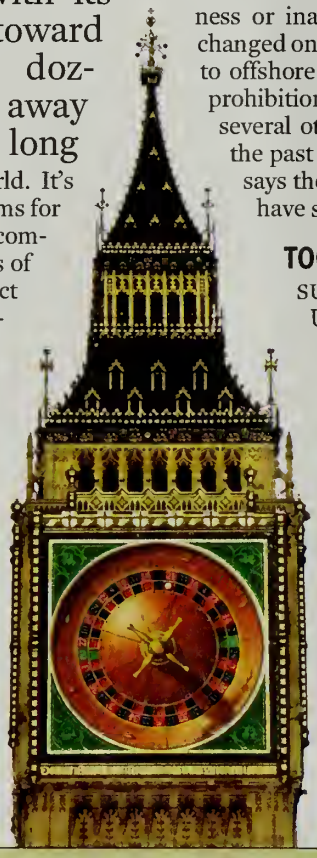
It's winning the listings war against New York, but investors can get burned

THE LONDON STOCK EXCHANGE is eating the New York Stock Exchange's lunch. So far this year, the LSE, along with its AIM market geared toward smaller companies, has lured dozens of initial public offerings away from the NYSE and NASDAQ, long the most sought-after stock markets in the world. It's done that in part by offering companies easier terms for listing and maintaining their shares. Whereas companies listed in New York are subject to the rigors of the Sarbanes-Oxley Act and other relatively strict standards, the London exchange relies almost exclusively on disclosure.

But just because London's listings are soaring doesn't mean it's doing a better job of raising capital. All major stock markets have weak companies, but the new issues in London these days seem especially so. "This is the worst dreck I've ever seen," the renowned short-seller James Chanos of Kynikos Associates declared recently in a New York speech. Chanos, who has sounded alarms about U.S. companies such as Tyco, Conseco, and Enron over a 25-year career, now maintains a London office and research staff to short-sell LSE issues.

To be sure, dependable companies like BP, HSBC Holdings, and GlaxoSmithKline still dominate London, one of the oldest and most developed centers of capitalism in the world. But when half a dozen stocks of online gambling companies plummeted recently, London's easier standards were cast in an unflattering light. The biggest loss in stock value came from online casino operator PartyGaming, one of the LSE's biggest offerings in five ears when it listed in June, 2005. Investors forked over $1.9 billion, all of which went to PartyGaming's founders instead of the company itself. (In U.S. deals, insiders take only about 15% of an initial public offering's proceeds, if any.) PartyGaming is owned mainly by an American couple who live in Gibraltar. Operating PartyPoker.com from computers in a Native American territory in Canada, the company v getting nearly 90% of its revenue from U.S. residents, wh online gambling was and remains illegal.

PartyGaming noted as much in its prospectus. And it ad that its directors "take comfort...in an apparent unwilli ness or inability" of authorities to enforce the law. T changed on Oct. 13, when the U.S. outlawed money trans to offshore gambling sites, finally giving some teeth to prohibition on Internet betting. Shares of PartyGaming a several other online casinos, all listed in London dur the past two years, plunged. A PartyGaming spokesm says the original owners still hold 70% of the stock have suffered, too.



TOO RISKY FOR THE U.S.

SUCH COMPANIES COULDN'T go public in U.S., says Jeffrey R. Houle, a lawyer at Greenb Traurig. The Securities & Exchange Commiss wouldn't have been satisfied with the risk dis sure in the prospectus. The threat of class acti would have been another obstacle.

Nevertheless, easier listing practices h helped London snag deals worth 58% of value of IPOs listed by the two financial cen this year, according to Dealogic. That's promp the New York exchanges, Treasury Secre Henry M. Paulson Jr., and others to push to m U.S. markets more appealing to companies sel stock—to make them a little more like Londo

An LSE spokesman says the exchange is th ing because it uses disclosures to police new is without complex and costly rules. And he says risks of gambling stocks were fully disclosed.

But there are other signs that the bloom i LSE IPOs. Of new issues over $100 million year, LSE-listed stocks are up only vs. 20% for NYSE stocks, a revers 2005 results, according to Deal The share prices of NASDAQ is of at least $100 million beat those London's AIM, rising 5.5%, vs. a 0 drop this year, and 35.2% vs. 12.3 2005. Lots of reasons could acc for the differences. One could be investors are wary of getting bur Buyers of PartyGaming share offer are now out about $1.6 billion. So times markets are like casinos— sometimes they're worse. ■

Rolling the Dice

Selected London IPOs of gaming-related companies

OATE	COMPANY	SHARE PRICE FROM OFFERING THROUGH NOV. 13
2/16/2006	Excapsa Software Inc.	–82%
6/27/2005	PartyGaming	–74
6/15/2005	Empire Online	–73
10/4/2005	Fairground Gaming	–68

Data: Thomson Financial

Real-time traffic monitoring available only in select markets. First three months' service included.
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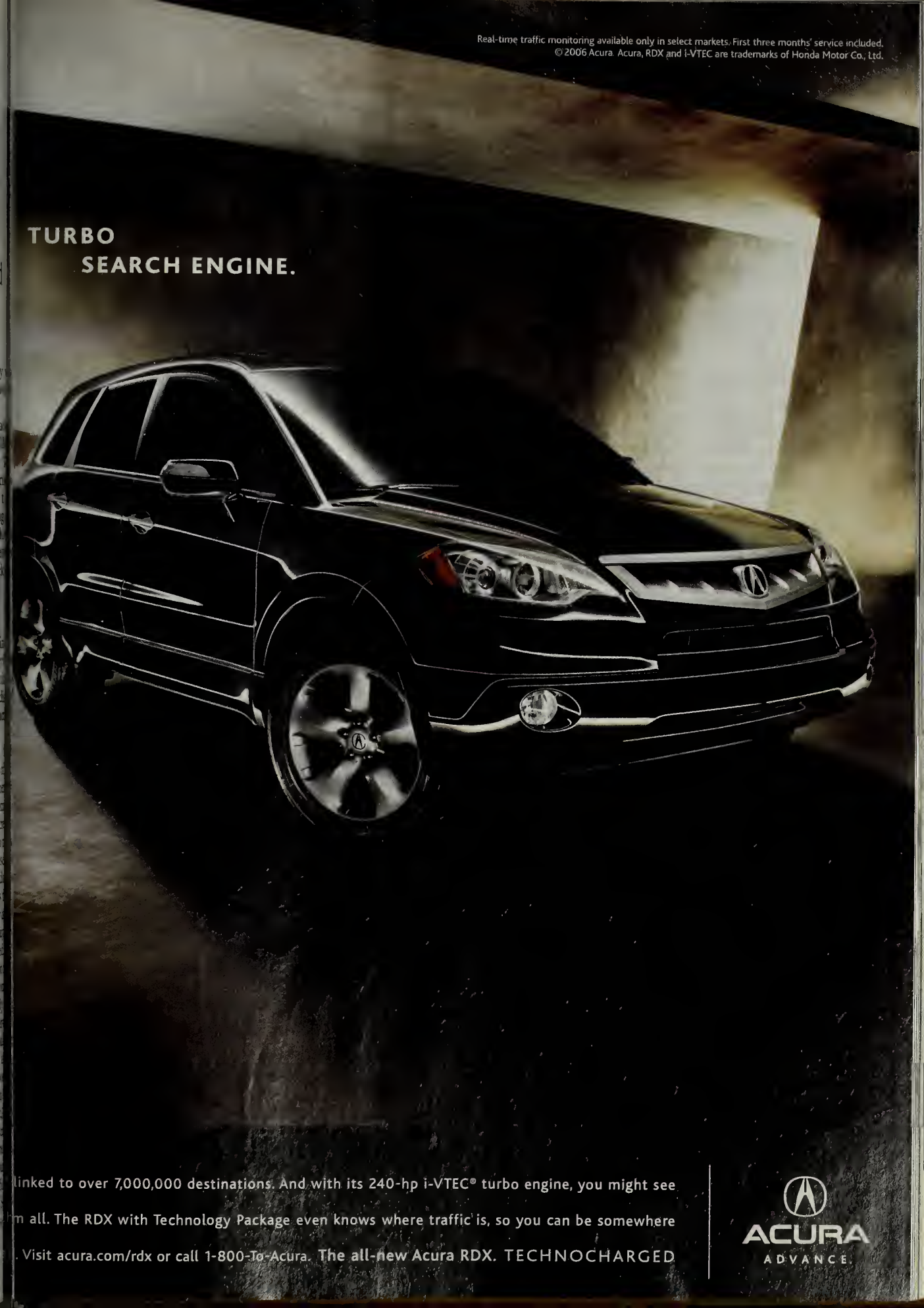

HEALTH CARE

MORE MICRO, LESS SOFT

The software giant is leading the private sector in doing something about obese employees

BY MICHELLE CONLIN

STEVE BALLMER HATES it when Microsoft loses. But for the screamingly competitive CEO, there is one single, glaring exception: the 61,100 pounds that have vanished from the bodies of 2,152 Microsoft Corp. employees since 2002.

Alas, the eating season is upon us. And with the recent news that mouse jockeys are more supersized than ever, Microsoft and a growing number of companies are on the attack against fat. Two-thirds of Americans are overweight, with the problem adding an average 20% more in costs to company medical claims. Indeed, more than ever before, Cubicle Land is becoming a place of McMansion bodies and big backyards.

To fight back, employers are doing everything from ripping out elevators and installing stairs to building parking lots a five-minute walk away, as Sprint Nextel Corp. did at its Overland Park (Kan.) headquarters. But with Microsoft the biggest loser in Corporate America, the company's pioneering on this front offers lessons in managing excess worker waistage.

Rather than simply adding tips on the low-cal life to in-house newsletter *MicroNews*, or popping for some Jenny Craig, Microsoft created a weight management benefit (employees already get free medical coverage). The software giant picks up 80% of the tab—up to $6,000—for a comprehensive, clinical weight-loss program. Expensive, yes. But Cecily Hall, Microsoft's director of U.S. benefits, says the company has already realized a one-to-one return on investment since the program began in 2002. "These people are coming off of prescription drugs, they're seeing their primary care physician less, and not having as much hospitalization," says Hall.

Microsoft's weight management benefit includes up to a year's worth of sessions with a personal trainer, behavioral and nutritional counseling, support groups, and medical supervision. Its war against weight started in 2002, about the same time Ballmer, then all puff and jowl, lost a fast 50 and turned taut a lean. His newly restructured physiq was the inspiration of Redmond, a soon 800 Microsofties were forgoing t logger-man portions in the cafeteria a subbing diet sodas for the free pop.

THIN MAN Armstrong now eats 2,000 calories a day

Today, the program is open to employees who are obese, or who a clinically overweight and have at le two other diseases, such as hyperte sion and depression. A little over a y ago, Strohm Armstrong, 44, weigh 295 pounds, suffered from high blo pressure, and was on his way to Typ diabetes. He thought he'd never see day past 70. But after worsening ba problems in the fall of 2005, the 5-fo 7-inch technical writer signed on a soon found himself in a spec workout facility with priv changing rooms to avoid lo er room embarrassment.

Now, after a year of e ing 2,000 calories a day, Ar strong has lost 116 pou and is down to a hardbo 179. The back pain, h blood pressure, and threa diabetes are gone. He r 5K races, exercises at le five times a week, has a chicken wings at the bar inst of a few dozen, and knows eating is of more about emotions than hunger.

For all the benefits Armstrong a others have gotten, some critics fear creation of a new nanny corporati where employers increasingly mo tor personal issues that cost th money. But as long as companies on the hook for health-care co age, don't expect their mothering change anytime soon. ■

BusinessWeek weekend To see a video report on how Pitney Bowes is taking corporate health care to new heights, go to www.businessweek.com/go/tv/health.

How to put your foot in your mouth

Do not attempt while standing; instability and possible collapse may result!

Fig. 1. Remove shoe

Fig. 2. Open mouth

Fig. 3. Insert foot (do not bite)

How to keep your foot out of your mouth

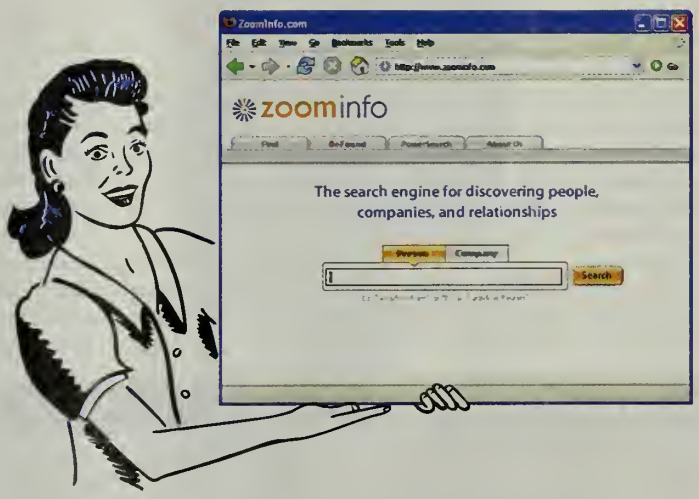

Fig. 1. Use www.ZoomInfo.com

a **www.ZoomInfo.com** search before any meeting, phone call or presentation – and g: instant expertise on 32 million business people, 2 million companies, what they do, o they compete against, how well they do, and who knows whom. **Know your stuff.**

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AIRLINES

'WAL-MART WITH WINGS'

Unlike other discount carriers, Ryanair has stayed profitable by charging for every little bit of service

BY KERRY CAPELL

RYANAIR HOLDINGS PLC CEO Michael O'Leary makes no apologies for his penny-pinching. Want to check luggage? You'll pay up to $9.50 per bag for the privilege. Free drinks and snacks? Forget about it. Even a bottle of water will set you back $3.40. It's not just passengers who have to cough it up. Flight crew buy their own uniforms, and staff at Ryanair's spartan Dublin Airport headquarters must supply their own pens. After a customer sued Ryanair for charging $34 for the use of a wheelchair, the company added a 63¢ "wheelchair levy" to every ticket. Says O'Leary: "You want luxury? Go somewhere else."

Southwest Airlines Co. inspired O'Leary to bring the first discount carrier to Europe. Now as the best U.S. discounters have fallen on hard times, it's Ryanair that is emerging as the model for how to run a low-cost airline. Southwest, JetBlue Airways, AirTran Airways, and others have seen fuel and expansion costs take a big bite out of profits. At the same time, the majors, after years of struggling, have finally gotten their costs under better control and are often matching or beating the discounters on price.

To compete, U.S. low-fare carriers have taken the opposite approach of Ryanair, adding perks such as leather seats, live television, and business class. "All the low-cost carriers' costs have gotten a little out of control," says Tim Sieber, general manager of The Boyd Group Inc., an Evergreen (Colo.) aviation consultant.

CELL-PHONE MODEL

NOT SO AT RYANAIR. The short-haul carrier is making fistfuls of money, even as it slashes fares. Despite a 42% hike in fuel prices, Ryanair's profits for the six months ended Sept. 30 soared 39%, to $422 million, on sales of $1.6 billion.

O'Leary's secret? He thinks like a retailer and charges for absolutely every little thing, except the seat itself. Imagine the seat as akin to a cell phone: It comes free, or nearly free, but its owner win up spending on all sorts of services. La year, Ryanair gave away 25% of its sea a figure O'Leary thinks he can doul within five years. In the not-too-dista future, he wants all seats to go for free

What O'Leary loses in seat revenu he figures he'll more than make up turning both his planes and the Ryan Web site into stores brimming with resistible goodies, even as he charges such "perks" as priority boarding a assigned seating.

Outrageous? You bet, but the strate is working. Although its average fare $53, compared with $92 for Southwe Ryanair's net margins are, at 18%, mo than double the 7% achieved by Sou west. "Ryanair is Wal-Mart with wing says Nick van den Brul, an aviation an lyst at Exane BNP Paribas in London.

O'Leary has plenty of clever new wa to make money. He has turned his plan into giant billboards, displaying ads such companies as Vodafone Group, Ja uar, and Hertz. Soon, ads will also st

PLAYBOOK: BEST-PRACTICE IDEAS

The Art of Cheap

How Ryanair has given new meaning to the term "no-frills"

GIVE 'EM AWAY

A quarter of Ryanair's seats are free: Passengers pay only taxes and fees of about $10-$24. The average one-way fare is $52.

EXTRAS COST EXTRA

Passengers pay for checked baggage ($9.50 per bag), bus rides to far-flung airports ($24), snacks ($5.50 for a hot dog)—even water ($3.40).

SELL, SELL, SELL

Flight attendants sell digital cameras ($137.50) and iPocket MP3 players ($165). Soon-to-come: onboard gaming and cell-phone service.

STRIP DOWN THE PLANES

The seats don't recline, and seat-back pockets have been removed. There's no entertainment; seat-back trays will soon carry ads.

BE AMAZON OF THE AIR

Ryanair sells more than 98% of its tickets online. Its Web site offers insurance, hotels, car rentals, and more—even online bingo.

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air will sell you
us or train ticket
o town.

Ryanair uses its Web
e, with 15 million unique
itors each month, to boost ancil-
y revenues. The company gets com-
ssions from sales of Hertz rental cars,
el rooms, ski packages, and travel in-
ance. For the year ended Mar. 31, such
illary revenues rose 36%, to $332
lion. "Every chance they get, Ryanair
s to squeeze just that little bit of extra
rgin out of its passengers," says Tim
es, a principal at London innovation
sulting firm Innovaro Ltd.

GH ROLLERS

E NEXT FRONTIER for O'Leary is
ning. Ryanair recently added online
nbling to its Web site, but O'Leary
ires there's more money to be had
offering gaming on his planes once
nair launches inflight mobile-phone
vice next year. "We have no idea how
online gambling will be, but we think
ill be significant," he says.

A willingness to take chances has
nsformed Ryanair from a near-bank-
t basket case back in the 1980s into
ope's most profitable airline. The
naround came after O'Leary met
thwest founder Herbert D. Kelleher
years ago. Kelleher imparted his for-
la for success over dinner at a Dallas
k house: Fly one type of plane to
ondary airports outside major cities.
p costs low and planes in the air, with
ck turnaround times. And forget perks
h as frequent-flier miles. O'Leary fol-
ed Kelleher's advice, leading Kelleher
lub Ryanair "the best imitation of Southwest Airlines that I have seen."

Ryanair, though, has always been much more than just a Southwest lookalike. For starters, Ryanair sells more than 98% of its tickets online, cutting down on administration costs and travel agent commissions. JetBlue sells 78% of its seats over the Internet, and Southwest just 59%. Ryanair's fleet of Boeing 737-800s have long ago been stripped down to the bare essentials. Seats don't recline, the better to cram in more passengers. Window shades have been removed, so flight attendants don't have to spend time resetting them between flights. Seat-back pockets have been ditched—one less place for clutter to accumulate.

Clearly, Kelleher's own combative stance against the status quo has provided O'Leary with an effective role model. He once made headlines calling European Union commissioners "communist morons," while dismissing the British Airport Authority as "overcharging rapists." He has dressed as the Pope to promote flights to Rome and has driven a tank to rival easyJet Airline Co.'s headquarters. "We specialize in cheap publicity stunts," he says.

O'Leary is also the master of the surprise move. For years, he has slammed Irish rival Aer Lingus as a "rip-off merchant." But he has since stunned the industry by launching a hostile $1.9 billion bid for the long-haul carrier. Aer Lingus shareholders have until Dec. 4 to accept the offer. If O'Leary wins control of Aer Lingus, he vows to sharply cut costs.

STUNT MAN
CEO O'Leary has launched a surprise bid for rival Aer Lingus

American long-haul discounters aren't likely to go to the extremes Ryanair has gone to sell basic services, but they're paying more attention to Ryanair these days. "They're on the cutting edge," says Tad Hutcheson, vice-president for marketing at AirTran, which recently assigned two marketing staffers to spend a week flying on Ryanair. "Charging for Cokes or snacks, blankets or pillows—I'm not sure Americans are ready for that."

–With Dean Foust in Atlanta

RISK TAKER Mark Tluszcz of Mangrove Partners in Milan

VENTURE CAPITAL

SEARCHING FOR AN ENCORE TO SKYPE

Mangrove Capital is betting the next Google will come out of Eastern Europe

BY GAIL EDMONDSON

SKYPE TECHNOLOGIES' brash European founders, Niklas Zennström and Janus Friius, had no product in 2003 when they pitched their business plan to Luxembourg venture fund Mangrove Capital Partners. Their idea was to attack a complacent global telecom industry with an ad-based service that offered free phone calls over the Internet—a plan that 20 venture capital groups already had rejected.

But Mangrove partners Mark Tluszcz (pronounced like Toulouse), Gérard Lopez, and Hans-Jürgen Schmitz were enthralled by the idea of wielding new technology to disrupt the economics of a trillion-dollar industry. And they weren't put off by a batch of U.S. lawsuits against Skype's founders related to their first startup, a music file-sharing startup similar to Napster. Mangrove's partners cut a check for seed funding of $130,000. "We like going against the odds," says Tluszcz.

That move catapulted Mangrove into the ranks of the world's top-performing VC companies. Skype's service took off like a rocket when it launched in 2004. Eighteen months later, following several rounds of additional funding, eBay Inc. bought the company for $2.6 billion, netting Mangrove $180 million on a total $1.9 million investment.

By betting on Skype, Tluszcz and team proved that Europe can produce world-beating Internet startups and that investors who back them can make sensational returns. One reason for Mangrove's success may be its U.S.-style embrace of risk, pouring up to 70% of its funds into early-stage investments. Like all such funds, Mangrove expects 40% of its investments to fail, but that's O. as long as there's an occasional grar slam. "Mangrove has the right attitude says Fergal Mullen, general partner Highland Capital Partners in Lexingto Mass. "They are taking big bets with ve disruptive technologies."

THE STAT

$180 million

Mangrove's net return on its $1.9 million, 18-month investment in Skype

Data: Company reports

THE NEXT BIG THING

WHILE MOST EUROPEAN VCs stick their own national backyards, Mangro canvasses the Continent for the be ideas. So where do they see the next wi ner? Tluszcz thinks real estate, whi remains highly fragmented in Europ looks especially promising.

Earlier this year, the group invest seed capital in Barcelona's Properaz Ltd., a Net-based startup that aims help consumers search for properties f sale and for rent from Lisbon to Mc cow. French founder Yannick Lacl has developed software that search property Web sites across Europe, trar lating data into numerous languag and displaying it on Properazzi's W site. The ad-based business will laun in a few weeks with 1 million propert creating a powerful search tool for t Continental market. "It's about brin ing transparency to a very opaque bu ness," says Tluszcz, who says users w be able to compare prices per squa meter for properties across Europe.

Mangrove is also betting some of t biggest Net hits will come out of Easte and Central Europe, where engineeri and mathematical skills run deep. "' see Eastern European entrepreneurs more fervently capitalist than Weste Europeans," says Lopez. In Janua Mangrove backed a Czech file-shari company called AllPeers Ltd. that allo users to share large files such as pho easily via their browser, avoiding the dium of uploading and downloading.

Mangrove is also ba ing Quintura, a Russ search-engine compa Working out of a drab f mer military compou surrounded by barbed w ex-Soviet scientists h developed a search gine based on the intuit model of the brain's neu networks. Quintura s its approach can achi better search results t both Google and Yah The next Skype? It's a l shot, but most Europ VCs would have never e bothered to look. ■

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Building a New Electric World

CARS

LAND OF THE LILLIPUT-PUTT

The Japanese are mad for minicars, a trend that's boosting Suzuki and others

BY IAN ROWLEY

TOYOTA, NISSAN, HONDA. For years that has been the market-share pecking order in Japan's giant auto market. But in October a stunning thing happened: Honda Motor Co. was outsold in Japan by Suzuki Motor Corp., an also-ran in the U.S. but a rising power at home. Suzuki's weapon of choice: the *kei*, or minicar.

While fuel-conscious Americans are snapping up subcompacts from Toyota, Nissan, and Honda, Japanese consumers are buying minicars in record numbers. These models make subcompacts look positively spacious. By law, a minicar in Japan can be no longer than 11 feet, and no wider than 5 feet. The engine of a typical minicar can't kick up more than 60 horsepower. Yet led by Suzuki, minicar makers account for 35% of all new auto sales so far this year, compared with 24% a decade ago. By yearend, sales should top 2 million for the first time. "Perceptions have changed," says Olivier Boulay, head of design at DaimlerChrysler's Advanced Design Center in Yokohama. "People have started to understand that with these tiny cars, you can have a nice mode of transportation that's affordable, doesn't use up too much gas, and has a touch of high tech."

That's a big switch from when many Japanese saw minicars as low-quality alternatives to larger rivals. New regulations in 1998 paved the way for stronger, sturdier, and slightly roomier *kei*. "Quality is improving every year," says Masahisa Ogawa, an executive at J.D. Power Asia Pacific Inc., which has bee surveying minicar quality since 200 (J.D. Power, like *BusinessWeek*, is owne by The McGraw-Hill Companies.) Jus as important, minicar quality has eve been gaining ground at a faster pace tha regular-size autos.

MINI MARGINS

INTENSE COMPETITION has also force carmakers to improve specs. Daihats Motor Co.'s Sonica, which ranges i price from $9,600 to $13,000, boasts continuously variable transmission an a turbocharged engine that gets 54 mile per gallon. Suzuki's new Cervo, launche on Nov. 7, includes Bluetooth connecti ity, a keyless entry system, and a choic of two- or four-wheel drive. In Octobe Mitsubishi's stylish i minic scooped up the Ministry Economy, Trade & Indu try's Good Design Gran Prix Prize for its innov tions, which include loca ing its engine in the re to increase space. "Th impression is that min cars have become as good as ordina cars," says Iwao Morii, project manag for minicar product development at Mi subishi Motors Corp.

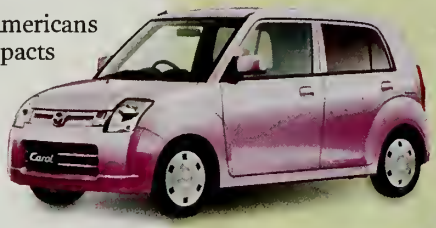
The growing popularity of minicars a boon for Suzuki, Daihatsu, and Mitsub shi, but the biggest automa ers have fewer reasons celebrate. Although Ni san and Toyota dor make these Lilliputi wonders, they do pro from the trend: Toyo owns 51% of Daihats while Nissan rebadg minicars from Suzu and Mitsubishi. Yet the prospect of minicar future doesn't make the majo happy. "The market is going toward mi cars," Nissan CEO Carlos Ghosn to reporters in October. "It's not favorab to us, but we have to recognize it." T reason for Ghosn's concern: Margins *kei* are as tiny as their backseats. Seda make more money, but those sedan sal are awfully pokey. Despite Japa economic recovery, regular sales were down 6.2% in C tober, the 16th consecuti year-over-year monthly cline. Only *kei* and luxu European imports are bu ing the trend. ■

–With Hiroko Tash in Tok

Hot Wheels

Minicars are on a roll in Japan

MITSUBISHI i The rear-engine car sells for $10,800 to $13,800



MAZDA CAROL A hit with women; prices range from $7,200 to $9,600

DAIHATSU SONICA Aimed at drivers in their 20s; prices run from $9,600 to $13,000

DAIHATSU COPEN A roadster with a retractable roof for $13,700 to $16,000

SUZUKI CERVO The latest model, out this month, is roomier; it goes for $8,900 to $11,800

Data: Company reports

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American importers have long answered criticism of conditions at their Chinese suppliers with labor rules and inspections. But many factories have just gotten better at concealing abuses

SECRETS, LIES, AND SWEATSHOPS

TANG YINGHONG WAS CAUGHT IN AN IMPOSSIBLE squeeze. For years, his employer, Ningbo Beifa Group, had prospered as a top supplier of pens, mechanical pencils, and highlighters to Wal-Mart Stores and other major retailers. But late last year, Tang learned that auditors from Wal-Mart, Beifa's biggest customer, were about to inspect labor conditions at the factory in the Chinese coastal city of Ningbo where he worked as an administrator. Wal-Mart had already on three occasions caught Beifa paying its 3,000 workers less than China's minimum wage and violating overtime rules, Tang says. Under the U.S. chain's labor rules, a fourth offense would end the relationship.

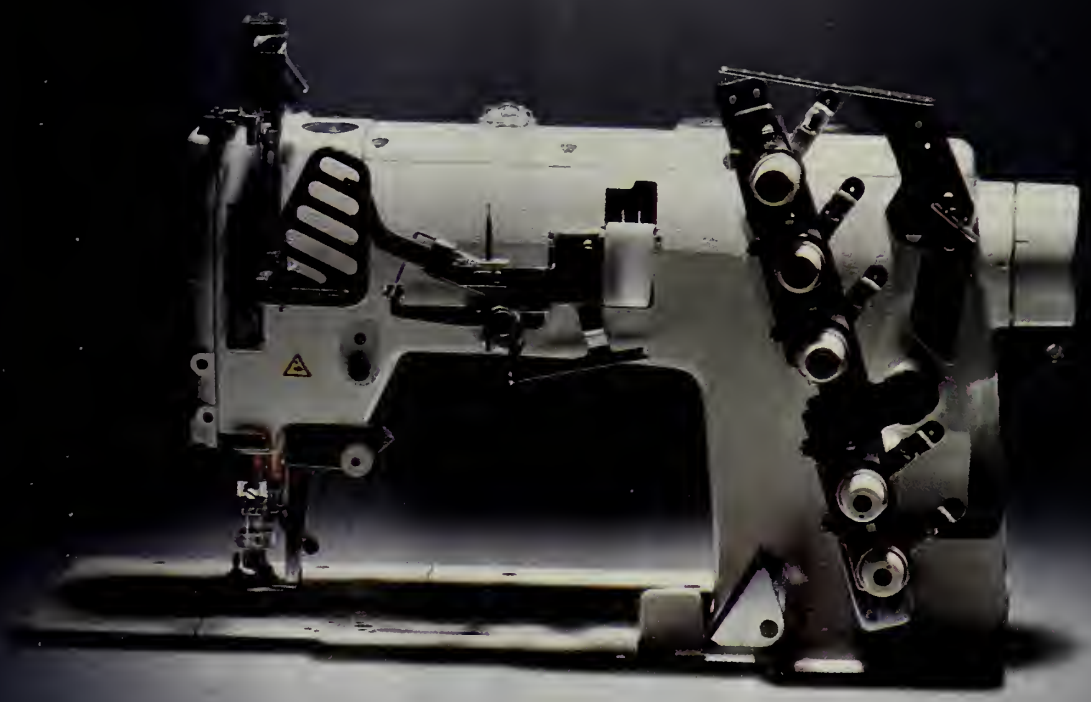
Help arrived suddenly in the form of an unexpected phone call from a man calling himself Lai Mingwei. The caller said he was with Shanghai Corporate Responsibility Management & Consulting Co., and for a $5,000 fee, he'd take care of Tang's Wal-Mart problem. "He promised us he could definitely get us a pass for the audit," Tang says.

Lai provided advice on how to create fake but authentic-looking records and suggested that Beifa hustle any workers with grievances out of the factory on the day of the audit, Tang recounts. The consultant also coached Beifa managers on what questions they could expect from Wal-Mart's inspectors, says Tang. After following much of Lai's advice, the Beifa factory in Ningbo passed the audit earlier this year, Tang sa even though the company didn't change any of its practice

For more than a decade, major American retailers a name brands have answered accusations that they expl "sweatshop" labor with elaborate codes of conduct and site monitoring. But in China many factories have just got better at concealing abuses. Internal industry docume reviewed by *BusinessWeek* reveal that numerous Chinese f tories keep double sets of books to fool auditors and distrib scripts for employees to recite if they are questioned. A a new breed of Chinese consultant has sprung up to ass companies like Beifa in evading audits. "Tutoring and helpi factories deal with audits has become an industry in Chin says Tang, 34, who recently left Beifa of his own volition start a Web site for workers.

A lawyer for Beifa, Zhou Jie, confirms that the compa employed the Shanghai consulting firm but denies any c honesty related to wages, hours, or outside monitoring. P audits had "disclosed some problems, and we took necess measures correspondingly," he explains in a letter respo ing to questions. The lawyer adds that Beifa has "become target of accusations" by former employees "whose unreas able demands have not been satisfied." Reached by cell pho a man identifying himself as Lai says that the Shang

By Dexter Roberts & Pete Engardio



consulting firm helps suppliers pass audits, but he declines to comment on his work for Beifa.

Wal-Mart spokeswoman Amy Wyatt says the giant retailer will investigate the allegations about Beifa brought to its attention by *BusinessWeek*. Wal-Mart has stepped up factory inspections, she adds, but it acknowledges that some suppliers are trying to undermine monitoring: "We recognize there is a problem. There are always improvements that need to be made, but we are confident that new procedures are improving conditions."

CHINESE EXPORT manufacturing is rife with tales of deception. The largest single source of American imports, China's factories this year are expected to ship goods to the U.S. worth $280 billion. American companies continually demand lower prices from their Chinese suppliers, allowing American consumers to enjoy inexpensive clothes, sneakers, and electronics. But factory managers in China complain in interviews that U.S. price pressure creates a powerful incentive to cheat on labor standards that American companies promote as a badge of responsible capitalism. These standards generally incorporate the official minimum wage, which is set by local or provincial governments and ranges from $45 to $101 a month. American companies also typically say they hew to the government-mandated workweek of 40 to 44 hours, beyond which higher overtime pay is required. These figures can be misleading, however, as the Beijing government has had only limited success in pushing local authorities to enforce Chinese labor laws. That's another reason abuses persist and factory oversight frequently fails.

Some American companies now concede that the cheating is far more pervasive than they had imagined. "We've come to realize that, while monitoring is crucial to measuring the performance of our suppliers, it doesn't per se lead to sustainable improvements," says Hannah Jones, Nike Inc.'s vice-president for corporate responsibility. "We still have the sa core problems."

This raises disturbing questions. Guarantees by mu nationals that offshore suppliers are meeting widely cepted codes of conduct have been important to mainta ing political support in the U.S. for growing trade ties w China, especially in the wake of protests by unions a antiglobalization activists. "For many retailers, audits ar way of covering themselves," says Auret van Heerden, ch

GAMING THE SYSTEM

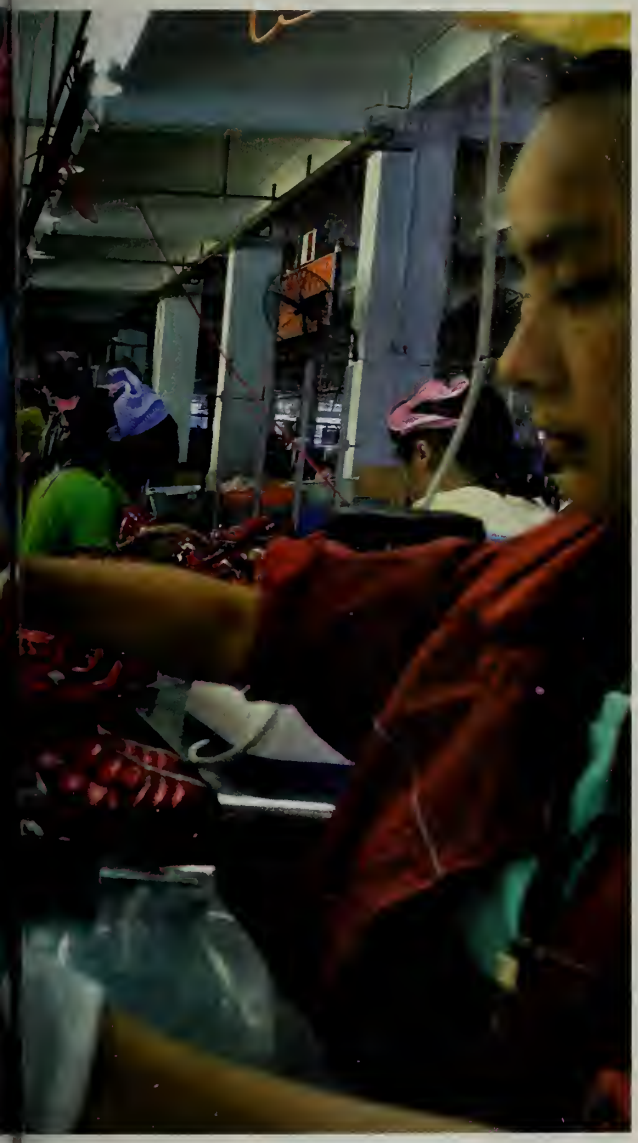
Some of the ways Chinese factories frustrate labor auditors sponsored by American retail chains and manufacturers:

DOUBLE BOOKS
Factories produce bogus payroll records and time sheets to show that workers are on the job 40 hours a week and receive proper overtime pay; the genuine books are kept secret.

SCRIPTED RESPONSES
Workers and managers are tutored on how to answer auditors' questions about hours, pay, and safety conditions; when interviewed off the premises, workers often give different answers.

HIDDEN PRODUCTION
Plants meet U.S. demands by secretly shifting work to subcontractors that violate pa or safety standards; some put workers in dangerous back rooms, hidden from auditors.

Data: *BusinessWeek*



T FOOTWORK Monitoring helps assess a nt's performance but may not result in rovement, says Nike's Jones (right)

cutive of the Fair Labor Assn., a coalition 20 apparel and sporting goods makers retailers, including Nike, Adidas Group, lie Bauer, and Nordstrom. But can cor- ations successfully impose Western labor ndards on a nation that lacks real unions a meaningful rule of law?

Historically associated with sweatshop ses but now trying to reform its suppliers, e says that one factory it caught falsifying rds several years ago is the Zhi Qiao Gar- nts Co. The dingy concrete-walled facility near mango groves and rice paddies in the steamy southern of Panyu employs 600 workers, most in their early 20s. y wear blue smocks and lean over stitching machines and e steam-blasting irons. Today the factory complies with r-law requirements, Nike says, but Zhi Qiao's general manager, Peter Wang, says it's not easy. "Before, we all played the cat-and-mouse game," but that has ended, he claims. "Any improvement you make costs more money." Providing for overtime wages is his biggest challenge, he says. By law, he is supposed to provide time-and-a-half pay after eight hours on weekdays and between double and triple pay for Saturdays, Sundays, and holidays. "The price [Nike pays] never increases one penny," Wang complains, "but compliance with labor codes definitely raises costs."

A Nike spokesman says in a written statement that the company, based in Beaverton, Ore., "believes wages are best set by the local marketplace in which a contract factory competes for its workforce." One way Nike and several other companies are seeking to improve labor conditions is teaching their suppliers more efficient production methods that reduce the need for overtime (page 56).

The problems in China aren't limited to garment factories, where labor activists have documented sweatshop conditions since the early 1990s. Widespread violations of Chinese labor laws are also surfacing in factories supplying everything from furniture and household appliances to electronics and computers. Hewlett-Packard, Dell, and other companies that rely heavily on contractors in China to supply notebook PCs, digital cameras, and handheld devices have formed an industry alliance to combat the abuses.

A compliance manager for a major multinational company who has overseen many factory audits says that the percentage of Chinese suppliers caught submitting false payroll records has risen from 46% to 75% in the past four years. This manager, who requested anonymity, estimates that only 20% of Chinese suppliers comply with wage rules, while just 5% obey hour limitations.

A RECENT VISIT by the compliance manager to a toy manufacturer in Shenzhen illustrated the crude ways that some suppliers conceal mistreatment. The manager recalls smelling strong paint fumes in the poorly ventilated and aging factory building. Young women employees were hunched over die-injection molds, using spray guns to paint storybook figurines. The compliance manager discovered a second workshop behind a locked door that a factory official initially refused to open but eventually did. In the back room, a young woman, who appeared to be under the legal working age of 16, tried to hide behind her co-workers on the production line, the visiting compliance manager says. The Chinese factory official admitted he was violating various work rules.

The situation in China is hard to keep in perspective. For all the shortcomings in factory conditions and oversight, even some critics say that workers' circumstances are improving overall. However compromised, pressure from multinationals has curbed some of the most egregious abuses by outside suppliers. Factories owned directly by such corporations as Motorola Inc. and General Electric Co. generally haven't been accused of mistreating their employees. And a booming economy and tightening labor supply in China have emboldened workers in some areas to demand better wages, frequently with success. Even so, many Chinese laborers, especially migrants from poor rural regions, still

seek to work as many hours as possible, regardless of whether they are properly paid.

In this shifting, often murky environment, labor auditing has mushroomed into a multimillion-dollar industry. Internal corporate investigators and such global auditing agencies as Cal Safety Compliance, SGS of Switzerland, and Bureau Veritas of France operate a convoluted and uncoordinated oversight system. They follow varying corporate codes of conduct, resulting in some big Chinese factories having to post seven or eight different sets of rules. Some factories receive almost daily visits from inspection teams demanding payroll and production records, facility tours, and interviews with managers and workers. "McDonald's, Walt Disney, and Wal-Mart are doing thousands of audits a year that are not harmonized," says van Heerden of Fair Labor. Among factory managers, "audit fatigue sets in," he says.

Some companies that thought they were making dramatic progress are discovering otherwise. A study commissioned by Nike last year covered 569 factories it uses in China and around the world that employ more than 300,000 workers. It found labor-code violations in every single one. Some factories "hide their work practices by maintaining two or even three sets of books," by coaching workers to "mislead auditors about their work hours, and by sending portions of production to unauthorized contractors where we have no oversight," the Nike study found.

THE FAIR LABOR ASSN. released its own study last November based on unannounced audits of 88 of its members' supplier factories in 18 countries. It found an average of 18 violations per factory, including excessive hours, underpayment of wages, health and safety problems, and worker harassment. The actual violation rate is probably higher, the FLA said, because "factory personnel have become sophisticated in concealing noncompliance related to wages. They often hide original documents and show monitors falsified books."

While recently auditing an apparel manufacturer in Dongguan that supplies American importers, the corporate compliance manager says he discussed wage levels with the factory's Hong Kong-based owner. The 2,000 employees who operate sewing and stitching machines in the multi-story complex often put in overtime but earn an average of only $125 a month, an amount the owner grudgingly acknowledged to the compliance manager doesn't meet Chinese overtime-pay requirements or corporate labor codes. "These goals are a fantasy," the owner said. "Maybe in two or three decades can meet them."

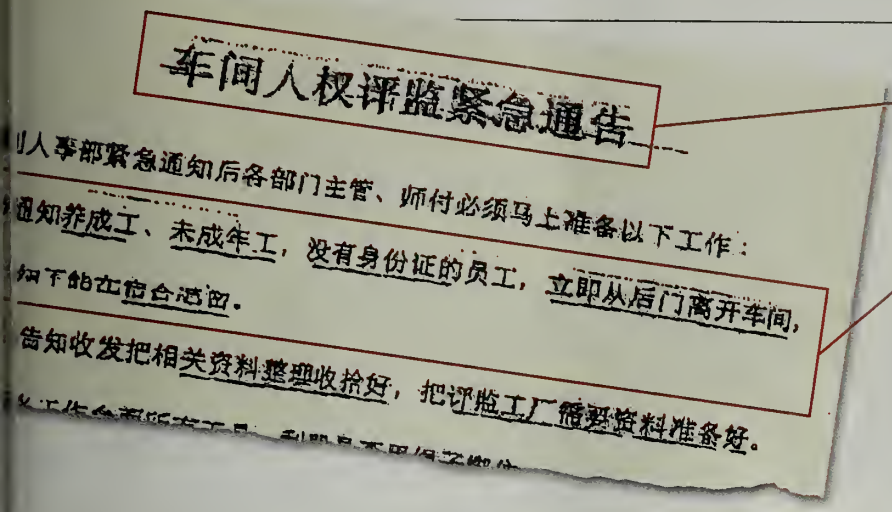
Pinning down what Chinese production workers are pa can be tricky. Based on Chinese government figures, the av age manufacturing wage in China is 64¢ an hour, accordi to the U.S. Bureau of Labor Statistics and demographer Jud Banister of Javelin Investments, a consulting firm in Beiji That rate assumes a 40-hour week. In fact, 60- to 100-ho weeks are common in China, meaning that the real manuf turing wage is far less. Based on his own calculations fr plant inspections, the veteran compliance manager estima that employees at garment, electronics, and other exp factories typically work more than 80 hours a week and ma only 42¢ an hour.

BusinessWeek reviewed summaries of 28 recent indus audits of Chinese factories serving U.S. customers. A few f tories supplying Black & Decker, Williams-Sonoma, and oth well-known brands turned up clean, the summaries show. I these facilities were the exceptions.

At most of the factories, auditors discovered reco apparently meant to falsify payrolls and time sheets. C typical report concerns Zhongshan Tat Shing Toys Facto which employs 650 people in the southern city of Zho

FOOLING THE AUDITORS

Coaching of workers and midlevel managers to undermine American companies' monitoring of Chinese factories is widespread. Here are excerpts from a memo distributed in a fabric factory in Guangzhou, Guangdong, about what to do in the event of an outside audit of labor conditions:



"Emergency Notice About Workshop Human Rights Inspections"

"First notify underage trainees, underage full-time workers, and workers without identification to leave the manufacturing workshop through the back door. Order them not to loiter near the dormitory area."

an. The factory's main customers are Wal-Mart and Tar-t. When an American-sponsored inspection team showed this spring, factory managers produced time sheets owing each worker put in eight hours a day, Monday rough Friday, and was paid double the local minimum ıge of 43¢ per hour for eight hours on Saturday, accord-g to an audit report.

But when auditors interviewed workers in one section, me said that they were paid less than the minimum wage d that most of them were obliged to work an extra three five hours a day, without overtime pay, the report shows. ost toiled an entire month without a day off. Workers told ditors that the factory had a different set of records show-g actual overtime hours, the report says. Factory officials imed that some of the papers had been destroyed by fire.

Wal-Mart's Wyatt doesn't dispute the discrepancies but esses that the company is getting more aggressive overall its monitoring. Wal-Mart says it does more audits than y other company—13,600 reviews of 7,200 factories last ar alone—and permanently banned 141 factories in 2005 a result of serious infractions, such as using child labor. a written statement, Target doesn't respond to the allega-ns but says that it "takes very seriously" the fair treatment of factory workers. It adds that it "is committed to taking corrective action—up to and including termination of the relationship for vendors" that violate local labor law or Target's code of conduct. The Zhongshan factory didn't respond to repeated requests for comment.

An audit late last year of Young Sun Lighting Co., a maker of lamps for Home Depot, Sears, and other retailers, highlighted similar inconsistencies. Every employee was on the job five days a week from 8 a.m. to 5:30 p.m., with a lunch break and no overtime hours, according to interviews with managers, as well as time sheets and payroll records provided by the 300-worker factory in Dongguan, an industrial city in Guangdong Province. But other records auditors found at the site and elsewhere—backed up by auditor interviews with workers—revealed that laborers worked an extra three to five hours a day with only one or two days a month off during peak production periods. Workers said they received overtime pay, but the "auditor strongly felt that these workers were coached," the audit report states.

Young Sun denies ever violating the rules set by its Western customers. In written answers to questions, the lighting manufacturer says that it doesn't coach employees on how to respond to auditors and that "at present, there are no"

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Sun microsystems share

workers who are putting in three to five extra hours a day and getting only one or two days off each month. Young Sun says that it follows all local Chinese overtime rules.

Home Depot doesn't contest the inconsistencies in the audit reports about Young Sun and three other factories in China. "There is no perfect factory, I can guarantee you," a company spokeswoman says. Instead of cutting off wayward suppliers, Home Depot says that it works with factories on corrective actions. If the retailer becomes aware of severe offenses, such as the use of child labor, it terminates the supplier. A Sears spokesman declined to comment.

Coaching of workers and midlevel managers to mislead auditors is widespread, the auditing reports and *BusinessWeek* interviews show. A document obtained last year during an inspection at one Chinese fabric export factory in the southern city of Guangzhou instructed administrators to take these actions when faced with a surprise audit: "First notify underage trainees, underage full-time workers, and workers without identification to leave the manufacturing workshop through the back door. Order them not to loiter near the dormitory area. Secondly, immediately order the receptionist to gather all relevant documents and papers." Other pointers include instructing all workers to put on necessa protective equipment such as earplugs and face masks.

FINDING A WAY Tang says consulting firms often help Chinese factories defeat labor code inspections

SOME U.S. RETAILERS SAY this evidence isn't represe tative and that their auditing efforts are working. *Busine Week* asked J.C. Penney Co. about audit reports includ among those the magazine reviewed that appear to sh falsification of records to hide overtime and pay violatio at two factories serving the large retailer. Penney spok woman Darcie M. Brossart says the company immediat investigated the factories, and its "auditors observed evidence of any legal compliance issues."

In any case, the two factories are too small to be seen typical, Penney executives argue. The chain has been cons dating its China supply base and says that 80% of its impo now come from factories with several thousand work apiece, which are managed by large Hong Kong trading co panies that employ their own auditors. Quality inspectors Penney and other buyers are at their supplier sites constan so overtime violations are hard to hide, Brossart says.

Chinese factory officials say, however, that just beca infractions are difficult to discern doesn't mean they're occurring. "It's a challenge for us to meet these codes of c duct," says Ron Chang, the Taiwanese general manager Nike supplier Shoetown Footwear Co., which employs 15,0

Realities of Outsourcing

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workers in Qingyuan, Guangdong. Given the fierce competition in China for foreign production work, "we can't ask Nike to increase our price," he says, so "how can we afford to pay the higher salary?" By reducing profit margins from 30% to 5% over the past 18 years, Shoetown has managed to stay in business and obey Nike's rules, he says.

But squeezing margins doesn't solve the larger social issue. Chang says he regularly loses skilled employees to rival factories that break the rules because many workers are eager to put in longer hours than he offers, regardless of whether tl get paid overtime rates. Ultimately, the economics of glo outsourcing may trump any system of oversight that West companies attempt. And these harsh economic realities co make it exceedingly difficult to achieve both the low pri and the humane working conditions that U.S. consum have been promised. ■

–With Aaron Bernstein in Washingt Stanley Holmes in Seattle, and Xiang Ji in Beij

HOW TO MAKE FACTORIES PLAY FAIR

CONCEDING THAT THE CURRENT system of auditing Chinese factories is failing to stop widespread abuses, more and more American companies are experimenting with new ways to enforce labor standards. The Fair Labor Assn., a coalition of American retailers and name brands, advocates using a single set of standards rather than the current babble of competing corporate codes. That would relieve audit overload at factories.

The Fair Factories Clearinghouse, a joint effort launched earlier this year by L.L. Bean, Reebok, Timberland, and other companies, is pooling social-compliance information on thousands of factories. Once a plant is certified by a reputable agency, other buyers can accept the results. Buyers also can band together to pressure factories to improve. "If 6 or 10 buyers have access to consistent information, they will be better able to use their influence to compel factories to abide by their standards," says Doug Cahn, Reebok's vice-president for human rights.

Sears, Roebuck & Co. and other importers are giving factories more time to become compliant on the theory that cutting off a factory after a certain number of failed audits can drive violations underground. Except for such egregious infractions as dangerous work conditions or use of child labor, these companies work with suppliers that seem willing to improve. Factories that fail to stick with the program get axed.

Nike Inc. uses a "balanced scorecard." When evaluating suppliers, it looks at labor code compliance along with measures such as price, quality, and delivery time. During crunch times, it allows some Chinese factories latitude by, for example, permitting them to adjust when employees can take days off. Nike also is trying to streamline its methods of designing shoes and placing orders with key suppliers. It is even helping foreign factories develop more efficient production techniques. By reducing bottlenecks, Nike hopes to cut the amount of overtime required in Chinese factories and eliminate a major source of labor abuse. "If you improve efficiency and innovation, it changes the cost equation" for factories, says Eric D. Sprunk, Nike's vice-president for global footwear operations.

> It is difficult to reform labor practices in countries where the rule of law is weak

The question is whether such new approaches will improve the lot of the average Chinese worker. Issues like nonpayment of wages, overtime without extra pay, and refusal to let workers organize unions "are complex to solve, since they're about the rule of law in many countries," says Hannah Jones, Nike's vice-president for corporate responsibility. That's especially true in China, where local officials trying to draw factories to their area often don't enforce Chinese labor laws. "You can catch and fix a problem," Jones says, "but that doesn't change an industry."

–Pete Engardio and Dexter Roberts

OBSTACLES TO REFORM

Several powerful economic factors make it difficult to improve the lot of workers in China:

PRICE PRESSURES
Americans expect ever-lower prices for many goods, driving the demand for cheaper supplies from China. Since 1996, the price of men's shirts and sweaters has dropped 14%. Clocks and lamps have plunged 40%; toys and games, 30%.

FEW ALTERNATIVES
Other low-wage nations enforce labor laws more effectively, but they cannnot match China's efficient workforce, physical infrastructure, component supply base, or massive manufacturing capacity.

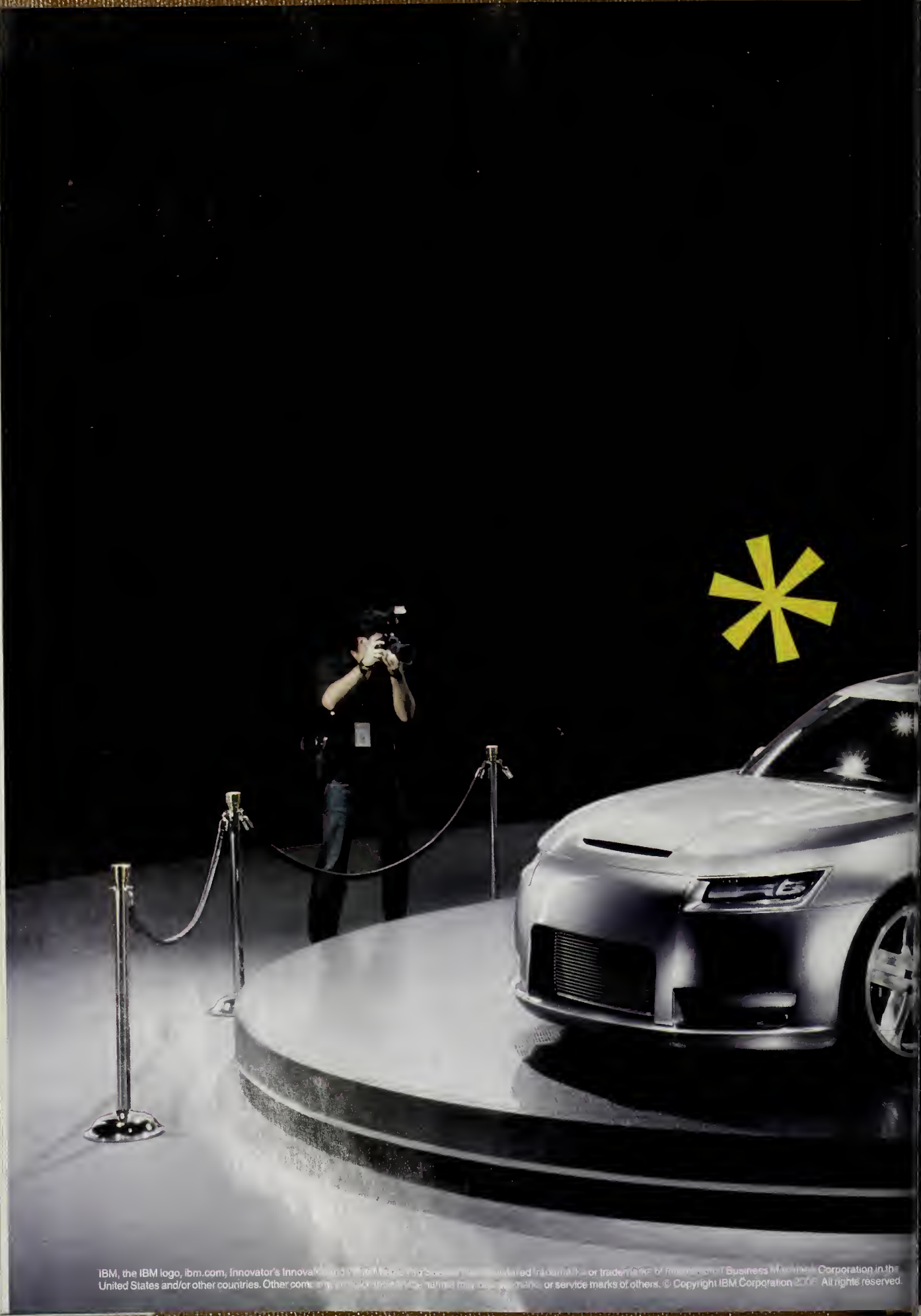
WORKER DEMANDS
Many young Chinese production workers want to earn as much as they can in a few years and then return to homes in the countryside. They often insist on logging as many hours as possible, even if they don't get full overtime pay.

in

NSIDE INNOVATION

VEMBER 2006

BusinessWeek



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Face it. There are all kinds of innovations but the most difficult—by far—is the redesign of your business model. In IN3, the third edition of *Inside Innovation*, we show just how hard it is to create a new, customer-centric, globally competitive business culture. We analyze mistakes Kodak made on the road to innovation and how it's trying to do with images what Apple has done with music. We also take a look at the successful redesign of Electrolux's business model. And check out the stories on what it really takes to do business in Second Life (all hype aside), the hot new motorcycle powered by a hydrogen fuel cell, and the latest in outsourcing to India. Keep in touch by linking to our online Innovation & Design site (businessweek.com/innovate).

BRUCE NUSSBAUM, EDITOR

04 inshort
Tools and trends to spur creativity

06 inasia
Wipro CEO Azim Premji discusses outsourcing innovation

08 intrend
Trend-spotting with author Robyn Waters

10 inmind
Brainstorming on ways to increase use of the Firefox browser

12 indepth
ELECTROLUX REDESIGNS ITSELF
Johan Hjertonsson's drive for change

17 inside
SECOND LIFE LESSONS
Real world businesses in a 3D virtual world and how to set up shop there

26 infocus
REINVENTING KODAK—AGAIN
Mistakes made and important lessons learned along the way

32 insight
How to deliver great customer experiences

34 inblogs
On going green

36 inprogress
Designing a better legal system

38 indesign
A motorcycle that runs clean and quiet

40 indata
Energy use and the ecological footprint

inshort

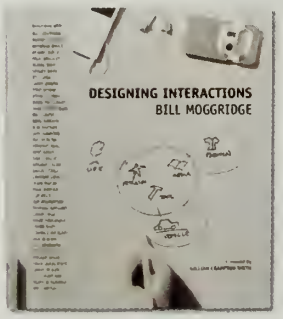
Reena Jana

TOOL: INNOVATION RADAR

Innovation progress can be tough for managers to define, diagnose, and measure. Mohanbir Sawhney, director of Northwestern's Kellogg School of Management's Center for Research in Technology and Innovation, and Kellogg fellows Robert C. Wolcott and Inigo Arroniz have been compiling data on the innovation habits of companies such as Boeing, eBay, DuPont, Microsoft, Motorola, and Sony. They've come up with a tool called Innovation Radar. It's a framework of 12 "dimensions" (such as "brand" and "platform") that leading companies tend to consider before investing in a breakthrough technology or service. A company's strengths and weaknesses can be mapped via a simple computer program into a radar-like graph. The image pinpoints where to invest resources. The researchers are compiling a database of companies testing the tool and are actively seeking corporations to participate.

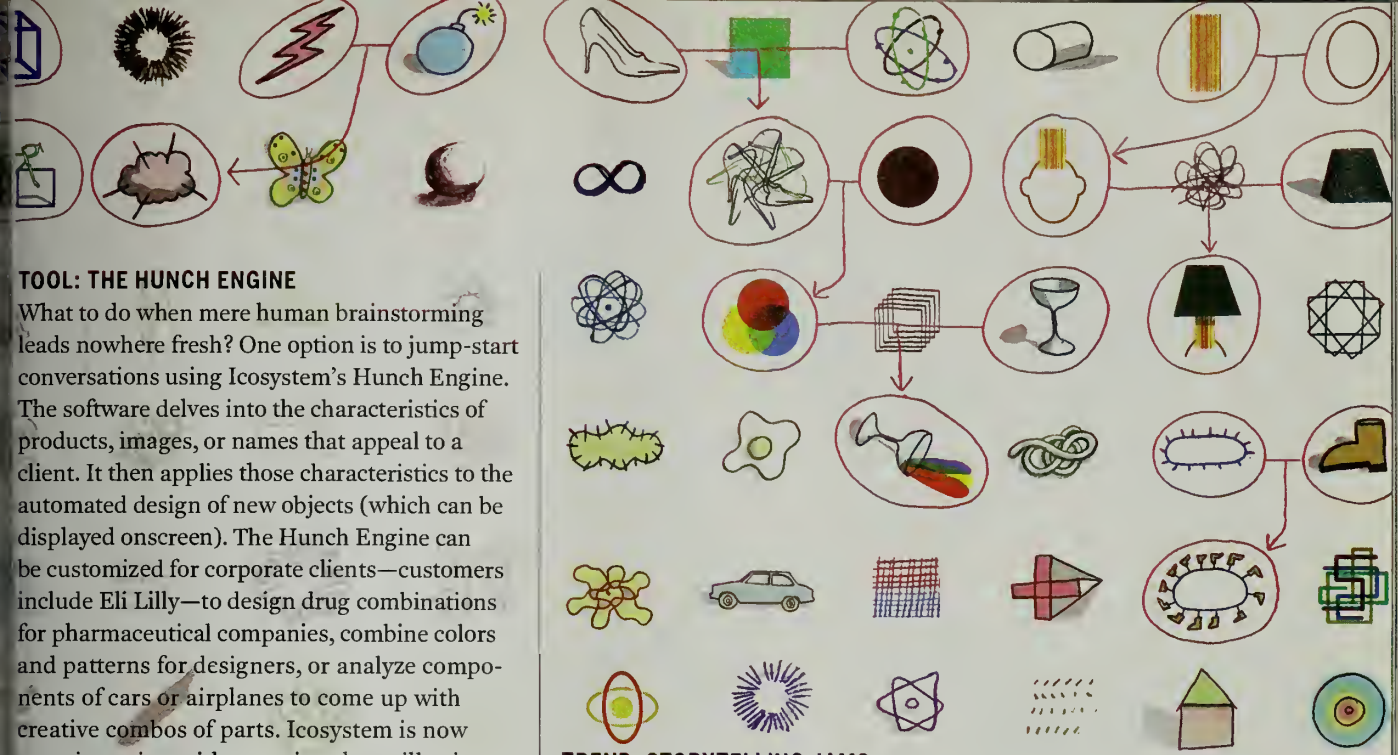
TREND: DISTANCE DESIGN EDUCATION

No time to sign up for an innovation workshop with consultancies such as Ziba or Doblin? Tap into a growing crop of design-education-at-a-distance resources for executives. Lunar Design features free podcasts that demystify design for the business community. Stanford University's D-school publishes *Ambidextrous* magazine and features case studies and ethnographic profiles of global consumers. And accompanying IDEO cofounder Bill Moggridge's new book, *Designing Interactions*, is a DVD (and Web site) with video clips, featuring lively interviews with Google's Sergey Brin and Larry Page on the importance of simplicity. Moggridge also features Electronic Arts' Will Wright constructing physical models and discussing how to maintain a gamer's attention.



TOOL: TAG CLOUDS

Tagging, or the bookmarking of digital photos and videos on content-sharing sites such as Flickr and YouTube, allows users to organize information and offers opportunities for quick market research. Amazon.com has recently started featuring customer tags that allow its shoppers to link to other, related products. Seeing how consumers associate products can inspire hybrid product designs or cross-promotional brand campaigns. Some sites, including Flickr, technorati.com (which tracks blog usage), and the recently launched Vox (a blogging service) offer tag clouds, which are graphic visualizations of tags that are "hotter" among users, depicted with larger type. Tag clouds can provide quick snapshots of what topics, products, and trends are most popular at any given time.

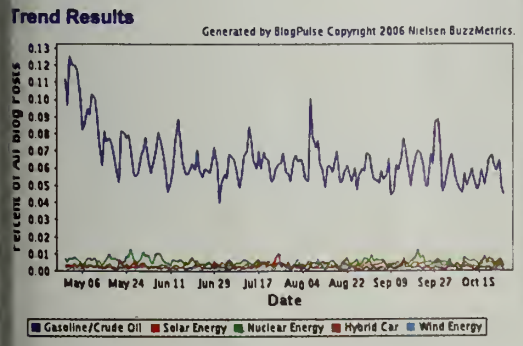


TOOL: THE HUNCH ENGINE

What to do when mere human brainstorming leads nowhere fresh? One option is to jump-start conversations using Icosystem's Hunch Engine. The software delves into the characteristics of products, images, or names that appeal to a client. It then applies those characteristics to the automated design of new objects (which can be displayed onscreen). The Hunch Engine can be customized for corporate clients—customers include Eli Lilly—to design drug combinations for pharmaceutical companies, combine colors and patterns for designers, or analyze components of cars or airplanes to come up with creative combos of parts. Icosystem is now experimenting with a version that will spit out striking, original brand or product names.

TOOL: MAPPING TRENDS AND INFLUENCE

There are tools that can research traffic on blogs, vlogs, and social-networking sites to check out how your brand is doing in the blogosphere. Nielsen BuzzMetrics offers BlogPulse, which allows users to make instant, customized graphs of how frequently topics are discussed on blogs. Designer David Armano has elegantly mapped popular (and unpopular) bloggers' spheres of influence on his Web site, Logic+Emotion. Cymfony's Orchestra allows people to visually track developing trends and consumer feedback across both consumer-generated media and traditional media sources. And Google Trends presents data on the public's Googling habits via colorful graphs and charts.



TREND: STORYTELLING JAMS

Storytelling has been gaining steam in corporations. Think of the power of strong brand narratives. The Moth, a literary organization in Manhattan (known for featuring Frank McCourt and Malcolm Gladwell [below], among other best-selling authors, in open-mike settings), offers sessions tailored to companies' needs. The Moth's distinguishing factor is its focus on helping companies describe and develop imaginative product design. Leading design consultancies Design Continuum and Studio Red at the Rockwell Group have signed up for MothShops, as the storytelling jams are called, as have major brands Pfizer and Liz Claiborne.

TOOL: MENTAL MODELS

Indi Young, a founding partner of user-experience consultants Adaptive Path, creates color-coded diagrams she calls "mental models" for clients seeking to revamp their Web sites with imaginative new features such as photo-sharing. Young outlines how customers experience a Web offering first-hand, then tries to translate that to clickable Web actions. The diagrams provide a picture of what customers want to accomplish via a site. The mental models also compare these expectations with what's already offered. The goal is to provide a single landscape (some paper maps are up to 24 feet wide) that reveals gaps and strengths before redesigning a client's Web site. Young and her Adaptive Path colleagues have made diagrams for Dow Corning, Microsoft, Princess Cruises, and Wells Fargo.

Wipro CEO Azim Premji Discusses Outsourcing Innovation, R&D Mistakes, and Boosting India's Talent Pool

Azim Premji was entering his senior year at Stanford University studying engineering in the 1960s when he got a call saying his father had passed away and he needed to return home to save the family peanut oil business. He did, and ultimately transformed it into Wipro Technologies, one of the top technology services companies in India—and the world. Premji talked to IN Editor Bruce Nussbaum about business model innovation and the rise of R&D outsourcing to India.

Q: The outsourcing model is changing fast in India. What's happening?

A: First, in the 1990s we had a new business model in the software industry. U.S. and European companies began to do much of their work here. Then we had another innovation in the BPO [business process operations] industry. [They] now account for almost 20% of India's exports. The next wave is R&D as more companies set up corporate R&D centers in India. Morgan Stanley has set up a large center in Mumbai where they are doing significant mathematical modeling in terms of equity interpretation, risk assessment, risk management. Wipro's R&D business is over $550 million and represents nearly one-third of total revenues.

Q: Wipro has a growing innovation business. How do you organize it?

A: We have an innovation council consisting of the champions from different technology domains, practices, and vertical business units, which essentially sets strategy and direction and approves funding. We also have centers of excellence in each of our verticals, such as retailing and manufacturing. We have between 900 and 1,000 employees working in innovation. In terms of total value, the combined innovation revenue last year was about 5%, and our target is 10% over a three-year period.

Q: What are the biggest mistakes corporations make in their R&D?

A: Making R&D free of accountability. Eventually, R&D has to be linked to business profit. R&D has got to get routed into deliverables. Not being diverse is another mistake. The composition of human resources in R&D, especially male-female ratios, is important. The breakthrough innovation of low-cost flexi-packs for consumer goods [such as shampoo] was really pioneered in India by a team of women. Having a certain portfolio of projects is also very important. We have taken on six projects this year, which we call quantum innovation, of significant size and risk, which will probably start showing results in 12 to 24 months.

Q: Salaries for Indian talent are rising sharply. How is that affecting India?

A: An Indian engineer from a good university costs between $8,000 and $9,000 a year compared with $45,000 in the U.S. or Europe. Indian salaries are rising about 12% a year and American salaries are going up at 3% a year, so it would take more than 30 years for the two to converge.

The key issue is supply, not cost. We are increasing the basket of talent available to us by digging down into the second- and third- and fourth-level universities to retrain engineers and make them into successful software engineers. We are lending faculty and offering e-learning courses to students.

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The Author of *The Hummer and the Mini* on How to Spot What's New and What's Next

Trend guru and consultant Robyn Waters, former vice-president of Trend, Design, and Product Development at Target, is best known as the mastermind behind the retail chain's high-profile, high-revenue "design-for-all" marketing strategy. Her book, *The Hummer and the Mini: Navigating the Contradictions of the New Trend Landscape* (Portfolio), just came out. Water's first, *The Trendmaster's Guide: Get a Jump on What Your Customer Wants Next*, focused on how trends are launched. *The Hummer and the Mini* tells managers, designers, and marketers what trends they should pay attention to now.

To Waters, today's marketplace is defined by contradiction. Think of such trends as "masstige," or prestige for the masses (teapots, lights, and clothing designed by Michael Graves, Philippe Starck, and Isaac Mizrahi sold at Target), and "counterfeit authenticity" (BMW's M-School where amateurs can pay to pretend they're NASCAR stars by racing real, high-performance Bimmers). In *The Hummer and the Mini*, Waters, who runs her own consulting firm, rw Trend (rwtrend.com), uses aphorisms from Lao-tzu and lines from Marcel Proust, among other eclectic references, to offer practical business advice. IN's Reena Jana talked with Waters about her sources for tracking what's new and what's next.

Q: What are the guiding principles running through your new book?
A: I have a mantra that I use for implementing great ideas: Make it real. Keep it simple. Make it happen.

"Make it real" means don't try to be trendy for the sake of trend. Products need to relate to the real world of customers and make sense for their lives. We call that being authentic.

"Keep it simple," so a product's inherent goodness can be easily discovered. Unfortunately, simplicity is not a word we hear much about these days...

"Make it happen" because there are too many meetings in Corporate America, too much dialogue and analysis. When you know something is right, just do it. Too many great ideas fa'l by the wayside for lack of execution.

Q: How do you gauge what people are talking about, wearing, and buying?
A: I'm overwhelmed with trend and news services that I read. Some of my favorites: Trendwatching.com, MorningNewsBeat.com, Agenda [agendainc.com], IG Trend Central [trendcentral.com], the National Retail Federation's Smartbrief [smartbrief.com/nrf], Retail Forward's Retail News Today [retailforward.com], Sense Worldwide [senseworldwide.com], Innovation Weekly from NewsScan [www.newsscan.com], and WorthGlobal Style Network [www.wgsn.com].

I think there's a point where TMI [too much information] is a distraction. I talk about analexia, which refers to the belief that if it can't be measured, it isn't important. I think the information that's most important is the soft stuff, the information that can't be measured because it has to do with heart and soul and how something feels.

Q: Do you believe social networking sites like MySpace are a good forum t explore trends among teenagers and young adults?
A: These sites strike me as a way to fin out what pushes people's magic button The social networking sites are particu larly popular with today's youth and are useful indicators pointing to what's going on in their world.

Q: What's the value of YouTube and vlo (or video blogs) for scoping out trends?
A: One of the paradoxes is that precise because there is so much available on

these sites, and because it varies so incredibly, the sheer volume of options makes it difficult to track the meaningful indicators. Then again, precisely because there is so much content, when something does catch the attention of the larger viewing audience, it's exponentially more powerful compared to much of the other content that's offered that goes virtually unnoticed.

Q: What tools do you use for communication and collaboration?
A: I keep things pretty simple. My own personal philosophy is borrowed from Tom Peters in his *This I Believe* series. I find stories, heroes, and demos to be the most effective communication tools for new ideas, and the most inspiring.

Stories are examples or allegories from other industries that represent possibilities. Heroes are inspiring examples of what can be accomplished against all odds and reason. Demos are perhaps the most effective way to convince others of the possibilities. Show me is still a way to overcome objections and jump-start possibilities.

Q: Do you have any general tools for figuring out when a trend has reached its apex and is about to die?
A: I believe strongly in the trend curve as a tool. It's a simple bell-shaped curve. Incoming, pre-peak, peaking, post-peak, outgoing. At the top of the bell curve is when everyone has figured out what the trend is and more people want it. The product is in demand and available everywhere. Full price is still valid, but the second after it slips off the curve on the downside, the quantities sold diminishes rapidly, the price drops quickly and it is promoted aggressively. The best place to be on the trend curve is incoming and pre-peak....up to peaking.

Q: You practice what you call "walk in other worlds" to get outside your regular frame of reference. How and why do you do that?
A: Walking in another world is a good way to shake up the senses, revitalize your observational skills, and reframe the way you think about things. I recommend WGSN [Worth Global Style Network], the world's largest online trend service. In WGSN, you can take a virtual walk down King's Road in London, see what's happening at the Paris flea markets, take a tour of any trade show, all with a click of the mouse. It encourages you to draw your own conclusions based on your customer, brand, and mission.

I do believe it's important to get out in the real world and experience new things, try new products, go new places, discover new restaurants, go to new events. We spend too much of our time in front of a screen.

Q: When you were at Target, designers were rated on a 50/50 system. Can you explain this and tell us why it is an effective tool for managers?
A: I looked for a way to reward whole-brain thinking, using the left side and the right side of the brain to deliver stellar results. In the scoring system, 50% of the review points were based on the same numbers that the merchants used to evaluate their performance—financial results according to plan. That sent a signal that we weren't here just to design pretty things. We were partners in driving financial results.

The other 50% of the review score was allocated on more qualitative things such as teamwork, creative problem solving, personal growth, leadership skills...all the soft stuff that's really hard to measure. I determined that number based on feedback from the manager and merchant partners. I do think that it is a valuable scoring system for anyone in a creative department living in the real world of bottom-line accountability.

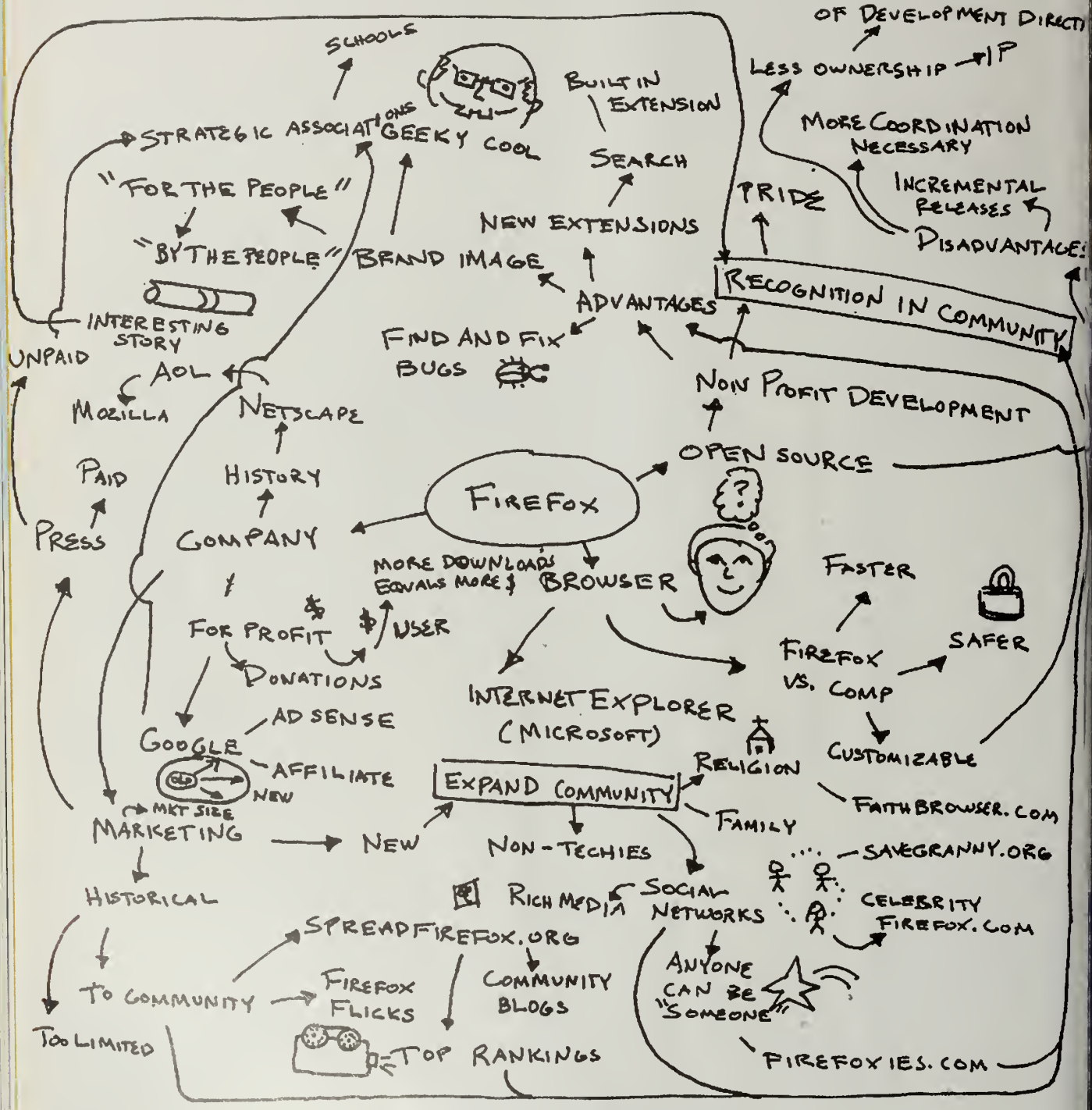
Q: Are there ethnography tools that you can recommend for managers?
A: I've been a part of shop-alongs, in-depth one-on-one interviews, and attended events as an observer and a participant. IDEO and Jump Associates use these tools with highly effective results. My trend hero is Yogi Berra, who's credited with saying: "You can observe a lot just by watching."

There are many different services and trend tools that will give you indications about what's next. But you have to use your instinct, intuition, and your heart in order to figure out what those observations are pointing to. Then you have to translate that knowledge into products and ideas that resonate with your customers' values. If you do that right, you'll be able to determine what's important, not just what's next. And that's when real innovation happens.

Q: Which companies do you recommend watching that are great at customized services to consumers?
A: Mass customization refers to products for a mass market that are designed so customers can personalize them to their exact needs or desires.

Companies doing a wonderful job of mass customization are: The U.S. Postal Service and the www.mystamps.com site. You can design your own postage stamps...upload a photo, chose a color, a border, a denomination, pay by credit card. Jones Soda uses digital technology to customize labels. The customer uploads a photo, writes a label, selects the flavor of soda, and a case of custom-labeled soda is shipped to their door. Starbucks allows you to customize your cup. There are purported to be over 19,000 ways to order your coffee drink at Starbucks. M&Ms allows you to select special fashion colors, and 95% of Mini Coopers are customized. Cold Stone Creamery customizes your cone with mix-ins. My Twinn is a doll that is customized to look exactly like your child. TiVo turns you into your own TV programmer. iPod gives you all the controls for your music when you want it.

I prefer the term "customer-made" to "custom-made." These examples turn a customer into a designer.



Mozilla wanted to expand the use of its Web browser, Firefox. Techies love Firefox, which is impervious to most viruses, but mainstream America hasn't embraced it. How does Mozilla translate innovation into market success? It turned to the "Creating Infectious Action" D-school class at Stanford University. Students prototyped Web sites and created a social networking site, Firefoxies.com, where users vote on the quality of friends' photos. The catch: You have to download Firefox to vote. So far, 30% of the site's visitors have done so.

Richard Wright's Life.
Owner of *Wright*—renowned auction house.
World-class purveyor of 20th Century Design.

Richard Wright's Life on a BlackBerry Pearl.

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BlackBerry Pearl

JOHAN HJERTONSSON, HEAD OF CONSUMER INNOVATION

Electrolux Redesigns Itself

By Ariane Sains and Stanley Reed

Johan Hjertonsson was lounging around his house outside Stockholm late one Saturday afternoon in 2003 when his boss, Electrolux CEO Hans Straberg called. "Hans said: 'We have a problem,'" recalls the 38-year-old Hjertonsson. "Things aren't moving fast enough." Sales were falling, products were taking too long to get to market, and consumers weren't sure why they should buy from Electrolux instead of the competition. Straberg told Hjertonsson: "I want you to fix this."

In the past, the CEO of the giant Swedish appliance maker would have dealt with weak sales by turning to the company's army of engineers to power up a new line of products. But this time, Straberg chose a more radical approach. Instead of letting Electrolux engineers dominate the development process, he opted to go with another model—teams of designers, engineers, marketers, and salespeople working together to design consumer-friendly products.

This model had been developed by Hjertonsson when he was marketing manager of the floor products and small appliance unit, which had been hit hard in the 1990s by cheaper Chinese products. The team-based approach became known as the Consumer Innovation Program. Hjertonsson reinvented his entire division, taking it from an engineer-driven, heavy manufacturer with full-scale operations in many countries to an integrated global company driven by teams and guided by consumer insights. He brought in innovation/design consultant IDEO to benchmark his program, then launched it in 2001.

By then, the entire company was having trouble from increasing Asian competition. In 2003, Hjertonsson, now head of Consumer Innovation, hired strategy consultant McKinsey & Co. to develop a questionnaire, which was sent to 500 managers. His team then followed up with 60 in-depth interviews. Four problems emerged: Managers didn't know enough about their customers, so they couldn't figure out what to develop; products were well-engineered but weren't filling consumer needs; R&D wasn't in sync with commercial product launches; and executives were afraid to take risks. "That," says Hjertonsson, "was the toughest and the hardest part to change."

In early 2004, Straberg and Hjertonsson began a six-week road show, visiting hundreds of company managers to explain the Consumer Innovation Program. "The reaction was: 'I met my quota last month, I met my budget, what's the big deal?'" Hjertonsson says. The big deal, as managers quickly learned,

Dustmate prototype from Spanish design students in the Electrolux Design Lab competition. The base of the shoe vacuums up floor dust. Walk through your house and clean as you go.

was that Straberg wasn't just interested in monthly quotas. He wanted to reinvent the company, changing the way products were developed, brought to market, and sold. He was calling for a total business-model revolution, not evolution.

Fast-forward to 2006, and Electrolux is morphing into a very different company. It uses a series of innovation metrics to measure unmet consumer needs and how well new products meet them; how products are developed and launched; and whether the right product and marketing managers are in the right jobs. Hjertonsson simply calls this "talent management."

Hjertonsson wields both carrots and sticks. Bonuses are based on how well managers adapt to the new system at Electrolux. The evaluation process includes a series of 30 questions aimed at figuring out how well managers are adapting to the regime. Electrolux uses three basic measures. First there is what they call "value market share" which is the portion of the consumer's wallet going to Electrolux versus other competitors. It is determined by the volume of appliances multiplied by the average price. Electrolux also looks closely at growth of profit margins and at average prices. The purpose of all three of these metrics is to shift focus to higher-value products and de-emphasize those that have become commoditized.

Those who resist change are given increasingly pointed warnings. Hjertonsson says someone who disregards the new message at first receives a polite lecture from that person's manager. If the behavior doesn't change, a more severe dressing down follows. Finally, an employee's manager is told that if the laggard doesn't shape up immediately, the individual should get the boot. "If you continue to invest time in these people, you slow this process down." Hjertonsson says.

One of the biggest changes in Electrolux is the switch from using marketing surveys that ask consumers what they want to actually visiting consumers in their homes to see how they use their appliances. "We never ask the consumer what they want," says Hjertonsson. "We do anthropology. We study the consumer."

The new consumer-centric focus has caught the attention of designers such as Henrik Otto, 41, who was recruited by Straberg in August, 2004, from carmaker Volvo to be Electrolux' design chief. Otto had been using a similar approach at Volvo and found the challenge of applying the method at a completely different kind of company irresistible. He also saw similarities between designing cars and designing appliances. "It's not purely about price and performance anymore. It's about the satisfaction people get out of the products," he says. "Now, people want their personalities to be reflected by their appliances."

Under Otto's leadership, the design department began asking "how do we make these products more emotional, and how do we get away from the boxy white look of home appliances?" Through home visits and interviews with more than 160,000 consumers worldwide, various types of core consumer profiles emerged. They were refined by Electrolux into four archetypes dubbed Anna, Catherine, Maria, and Monica to help the innovation teams visualize who they were developing products for.

Catherine is a neatness freak, while Anna just wants to get the chores over as quickly as possible. Monica is superefficient and Maria is a homebody who dotes on her family. Hjertonsson says the personas cut across nationality, age, and socioeconomic groups. During product development training sessions, managers are assigned one of the models and encouraged to think of her as a real person, giving her a fictional life story.

Straberg is training 700 managers, including nearly all of his top execs, in the methods of the Consumer Innovation Program. Working in small groups that include designers, engineers, and marketers, the managers develop their prototype products. By working in multidisciplinary teams from the be-

The Gentle Dryer prototype with yellow drum suggests summer breezes and clothes drying on the line. Scents are optional.

Cologne or perfume can be added. to this prototype for a handheld, cordless steam iron that removes stains and freshens fabrics.

ginning, designers avoid developing products that can't be engineered, engineers eschew technological solutions that aren't visually appealing, and marketers can help shape products so that retailers are more likely to give them prominent play.

Electrolux has a way to go in turning itself into an innovative, design-driven company. In a trial run of the training program, two senior management teams came up with prototype products and then submitted them to consumer panels for review. The upshot? "They killed us," says one participant. Some top managers still don't know how to appeal to consumers.

But others do. In Britain, home visits provided the inspiration for the Twin Clean vacuum. Consumer Innovation Program project director Anthony Ford, 40, went to one woman's house and watched as she struggled to clean the dust filter in a competitor's bagless vacuum. He decided Electrolux could make something better.

But his team didn't get it right the first time. The prototype they designed was rejected by consumers as too big and heavy. The problem, Otto says, was that the team zeroed in on a technical solution without considering how the vacuum would actually be used or how practical its size was. In short, the team failed in its ethnography. It may have looked at how people vacuumed, but it didn't really see how much they had to struggle to operate them. After a redesign, the Twin Clean hit store shelves in Europe in 2005 at 295 euros ($370), and has just launched in the U.S. at $500.

Two new refrigerators, Glacier and Source, have also come out of home visits. Richard Sells, director of the division for cold appliances, says that through the innovation process, including home visits and focus groups, his team learned that consumers wanted automatic icemakers in their refrigerators as well as water dispensers, but didn't like the amount of space they took. Consumers are also drinking more bottled water, but they find it bulky to bring home and worry about the environmental effects of all the packaging.

Electrolux' solution was to design smaller water and ice units and a water filter and carbonation system that is compact. Glacier and Source have automatic icemakers that are smaller than average, freeing up valuable refrigerator space. Source also has a carbonated water dispenser. Introduced in Europe in January, 2006, each refrigerator costs 3,220 euros ($1,600). The company is selling twice as many units as it had estimated.

Electrolux is also using design thinking to relaunch older products. Countertop dishwashers and frost-free freezers in Europe are cases in point. Electrolux relaunched a mini-dishwasher about the size of large microwave in Italy, aimed at households with one or two people. When these households have full-size dishwashers, they wait for them to be full, and run them only once or twice a week. That makes it harder to get dishes clean. It also means favorite mugs or plates can't be used every day. The Electrolux machine was marketed with the pitch that it allows those favorites to be used daily. Frank Dowling, North American marketing and design director, says home visits are helpful for his engineers. "It brings the consumer focus that a lot of the designers don't see," he says. That helped Electrolux engineers redesign dishwashers for the U.S. market, repositioning baskets and racks after watching consumers load machines.

While Straberg and Hjertonsson have made progress reinventing Electrolux, they don't kid themselves that they are finished. Hjertonsson believes it will take "many, many years," to complete the transformation. "Once you are on this quest," he says, "it is a continuous journey rather than a race." IN

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SECOND LIFE LESSONS

You may have heard the hype about popular 3D online universe Second Life, but setting up shop there presents unique challenges
By Reena Jana and Aili McConnon

ECONOMY

$9M IN BUSINESS BY RESIDENTS IN OCTOBER, 2006

12% GROWTH PER MONTH FOR 2006

287% ANNUAL GROWTH RATE TO DATE

For real-life companies from Warner Bros. to Adidas to Intel seeking to brand themselves as hip and forward-thinking, virtual community Second Life has quickly become a trendy marketing and advertising outlet. Opening virtual offices or shops, selling and market-testing digital replicas of products, and creating 3D online personas or "avatars" in Second Life are becoming items on the to-do lists of those eager to tap into the nascent market. The three-year-old Web-based world has more than one million "residents" who spent $9 million in October on virtual land, products, and services. And while advertising's traditional outlets are losing eyeballs, so far this year the population of Second Life has increased 995%—a growing potential consumer audience for marketing messages.

Second Life, of course, is still a work in progress. None of the companies spending real money to launch campaigns can yet gauge how successful their efforts will be, and virtual campaigns aren't without their own unique dangers. One problem is hackers, who periodically shut down Second Life. Linden Lab, the company behind the site, recently met with federal authorities to address this cybercrime. In addition, many long-time residents view the arrival of big brands as a threat to established mom-and-pop entrepreneurs. Annoyed vigilante residents have set off bombs—via malicious computer code—that destroy virtual buildings or cause the application on your computer to freeze. American Apparel has had to deal with virtual protesters scandalized by the scantily clad models in the company's real-world ads. And there is one weird technical glitch: When a space is swamped with visitors (more than 60 to 90), a bug in the system can make avatars' clothes disappear.

But Philip Rosedale, CEO of Linden Lab, says the supporting technology is continually advancing. "Second Life is improving in resolution and functionality at the rate of Moore's Law. The real world isn't getting better by the day." Rosedale views Second Life not as a multiplayer online role-playing game, like World of Warcraft, or in the same category as Will Wright's forthcoming Spore, which allows players to design their own species. Rather, he sees it as a new social-networking platform, like MySpace.

In the future, Rosedale conceives of Second Life as a possible 3D Web browser. The ambitious idea, as he explains, is that instead of using your mouse to click on links, you would direct your avatar to walk into a 3D Amazon.com shop, browse shelves, buy books, and chat over a virtual cup o' joe with other people visiting the site.

The current flood of companies announcing a Second Life presence echoes the late 1990s, when every CEO wanted an e-commerce site. Yet while Second Life is cool and timely, it's not easy to make real money selling virtual goods (cars go for $2 each). Why? Not enough volume. The registered population has passed a million, but only 10,000 people on average are online at any one time.

What sets Second Life apart is that the big-brand products offered can be customized by virtual users. And Second Life is an interactive, intensely social environment where companies hope not only to find customers and strengthen their brands but one day also to connect remote employees to one another and recruit new hires.

Clearly, for a company considering jumping into Second Life now, serious homework is needed. Turn the page to see which real-world industries have Second Lives and learn what steps to take and mistakes to avoid.

SECOND LIFE TIP SHEET
STEPS TO TAKE AND MISTAKES TO AVOID

1. Design your avatar. The first place to start—even just to research firsthand what other corporations are doing—is to sign up for a free Second Life account and create your avatar, or online alter-ego. If you want to buy property for your virtual store, you need to sign up for a $9.95-a-month premium account through PayPal.

2. Buy some land. Fees range from $5 for 512 square meters of a region to large islands priced at $5,000 for 262,144 square meters (about 64 acres) and $780 in monthly maintenance fees. Most real-world companies have been spending $1,250 for an island (about 16 acres).

3. Shop around for a developer. In Linden Lab's Developer Directory, you can find the right company to build your virtual office, get celebrities to perform at your launch event, and keep generating buzz with regular programs. Check out developers' Web-based portfolios and schedule an in-world tour of their past projects.

4. Define your brand experience. Some companies make the mistake of turning to virtual worlds for incremental revenue. Even though there is real money moving through Second Life, it does not yet produce a meaningful revenue stream for companies. Instead, focus on defining the core aspects of your brand and translating your products into virtual ones.

5. Understand the local culture. Take this as seriously as taking your company to a new country or continent. For example, do Second Life residents really wear and, more important, buy simple T-shirts and jeans? Many have flashy, costume-like clothes. Consider what styles and types of products would appeal in Second Life.

6. Define your virtual strategy. Launch your presence with a high-profile event and consider cross-promoting with other companies. Sony BMG launched in Second Life with a Ben Folds Five concert in the Aloft virtual hotel developed by Starwood Hotels & Resorts Worldwide. Also consider incentives. American Apparel offers a 15% discount to Second Life residents who visit online and later shop in a physical boutique.

7. Measure real-world results at regular intervals. Think of Second Life as a complement to, not a replacement for, a standard Web site or real-world presence. Even though only about 40 avatars attended a press conference with Mark Warner, former tech entrepreneur and Democratic Governor of Virginia, it was covered more widely by bloggers and the mainstream media than just another flesh-and-blood town hall meeting.

8. Troubleshoot tech and design issues. More than 60 to 90 visitors to a virtual event cause the server to slow down. The American Cancer Society had to turn away potential donors. Next year, it plans to host events in multiple locations to accommodate more Second Life residents. And boxy, modern buildings and objects tend to work best in Second Life (think of Telus' cube-like store or Toyota's Scion). Avoid more ornate designs.

9. Keep an eye on other Web worlds. While Second Life is getting popular, it could be even more innovative to explore alternative marketing platforms. Active Worlds' offers standalone immersive corporate worlds, which clients like Wells Fargo opted for instead of Second Life. There.com helped MTV develop an independent virtual Laguna Beach. Habbo, an offshoot of the pioneering virtual meeting place Habbo Hotel, is an online universe for teens. Cyworld is a growing Korean site that marries MySpace to Second Life.

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AIMEE WEBER STUDIO
New York

www.aimeeweber.com
Contact: Aimee Weber, founder
Number of employees: 5
Real-world clients: 15 (American Cancer Society, United Nations)
Average campaign length: 2 months
Cost: $5,000 to $250,000

ELECTRIC SHEEP COMPANY
Washington

www.electricsheepcompany.com
Contact: Giff Constable, vice-president of business development
Employees: 25
Real-world clients: 30 (Reuters, MLB, Text 100)
Average SL campaign: 1 to 3 months
Cost: $10,000 to $200,000

MILLIONS OF US
Sausalito, Calif.

www.millionsofus.com
Contact: Reuben Steiger, chief executive
Employees: 27
Real-world clients: 15 (Toyota, Warner Bros. Records)
Average campaign: 3 months
Cost: $20,000 to $400,000

RIVERS RUN RED
London

www.riversrunred.com
Contact: Justin Bovington, chief executive
Employees: 32
Real-world clients: 17 (Adidas, BBC Radio 1)
Average SL campaign: varies
Cost: $5,000 to $1 million (plus retainers)

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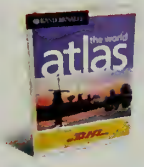

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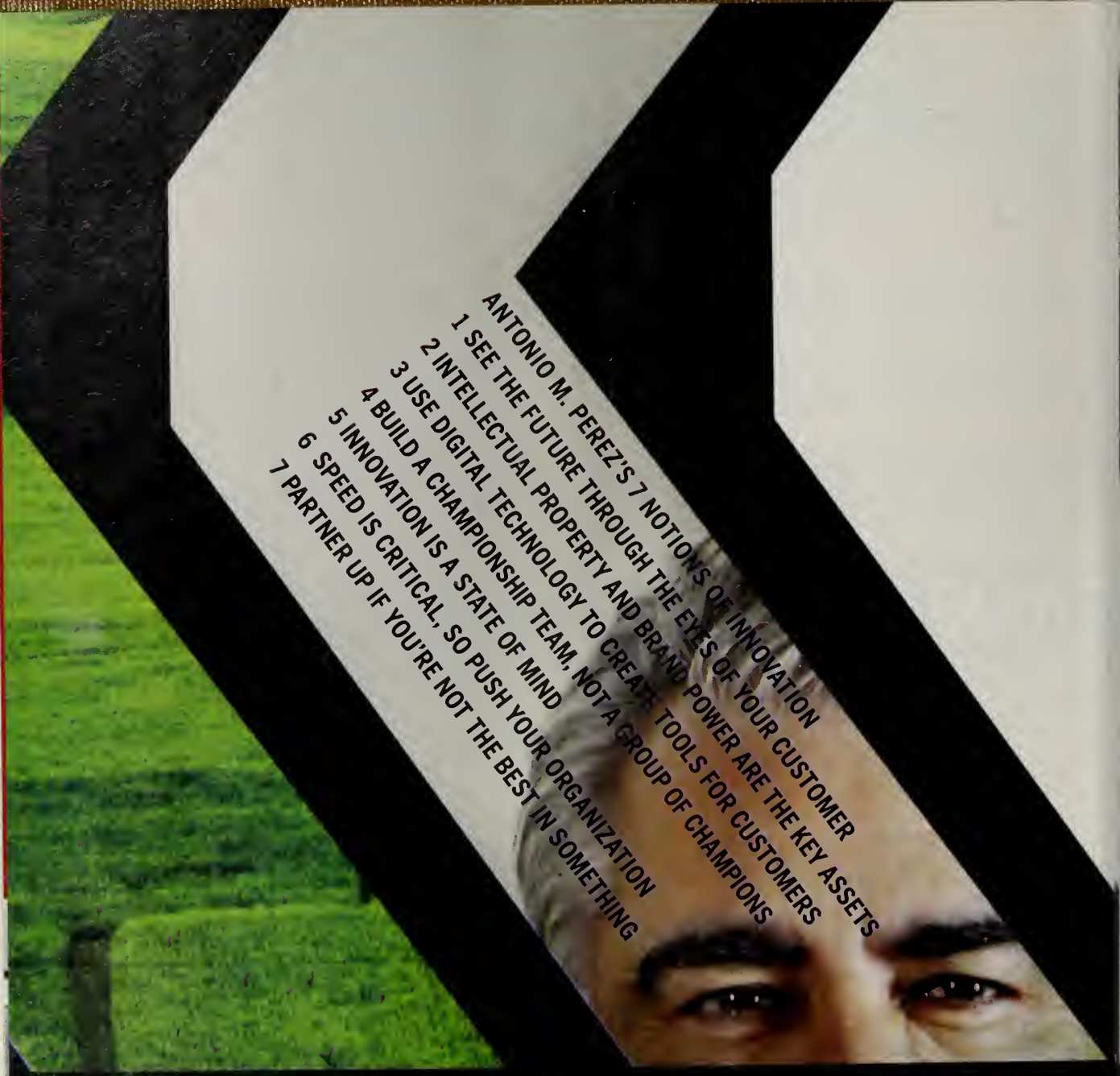


ANTONIO M. PEREZ'S 7 NOTIONS OF INNOVATION

1 SEE THE FUTURE THROUGH THE EYES OF YOUR CUSTOMER

2 INTELLECTUAL PROPERTY AND BRAND POWER ARE THE KEY ASSETS

3 USE DIGITAL TECHNOLOGY TO CREATE TOOLS FOR CUSTOMERS

4 BUILD A CHAMPIONSHIP TEAM, NOT A GROUP OF CHAMPIONS

5 INNOVATION IS A STATE OF MIND

6 SPEED IS CRITICAL, SO PUSH YOUR ORGANIZATION

7 PARTNER UP IF YOU'RE NOT THE BEST IN SOMETHING

STRATEGIES

BY STEVE HAMM AND WILLIAM C. SYMONDS

MISTAKES MADE ON THE ROAD TO INNOVATION

LED BY CEO ANTONIO M. PEREZ, KODAK IS STRUGGLING TO REINVENT ITS BUSINESS MODEL. IT'S NOT ALONE

When Eastman Kodak vowed in 2000 to become a leader in digital cameras, the idea seemed ludicrous. The old-line Rochester (N.Y.) company had film and print all through its DNA. Yet by 2005, Kodak ranked No.1 in the U.S. in digital camera sales. Its digital sales surged 40%, to $5.7 billion, even as its film-based businesses fell 18%. The key: product innovation, something Kodak knew how to do oh-so-well. The company designed one award-winning breakthrough after another to make digital photography nearly as simple as pointing and clicking.

So why does Kodak Chief Executive Antonio M. Perez now dump on digital cameras, calling them a "crappy business"? Simple: While blazing growth of camera sales has helped blunt the effects of Kodak's fast-fading film revenues, it hasn't replaced the rich profits of the film business. Even the best mass-market cameras yield slim profit margins. So, although Kodak's digital camera business was a roaring sales success, it turned out to be a crushing profit disappointment. Perez, who arrived at Kodak in 2003 and became chief executive last year, had championed a dramatic change only to find it wasn't the right model for turning the company around.

Now he's crafting yet another strategy for Kodak, its third in less than a decade. Building on the mistakes made and lessons learned in recent years, Perez is attempting innovation of another sort—reinventing the company's core business model. He aims to make Kodak do for photos what Apple does for music: help people to organize and manage their personal libraries of images. He's developing a slew of new digital photo services for consumers that he expects

to yield higher returns. They include everything from online photo sharing to a rapid-fire scanning system, called Scan the World, that takes shoe boxes full of yellowed snapshots and converts them into crisp digital images organized by the date originally printed. But the shift from hard product to digital services is a huge challenge. It's "a very hard transformation," says Perez. "History says very few companies have made it."

In an era when innovation is all the rage, many CEOS, like Perez, are discovering that product innovation alone isn't enough to save sick companies or turbocharge healthy ones. For many, their core businesses are being disrupted by globalization, technology shifts, and new competitors. They must reinvent the company. Even at healthy companies, business model innovations are essential to retaining their competitive positions. Microsoft Chief Executive Steve Ballmer says he no longer thinks of his competition as individual companies. Instead, "it's alternative business models that we'll have to compete with or embrace," he says. His two biggest threats are the open-source phenomenon and advertising-supported software.

There's no better example than Kodak of the importance of coming up with new ways of doing business—and the difficulties of succeeding. At its peak, Kodak was an icon of American technology innovation. Now it's fighting to recover from a tech revolution that is strangling its core business. Kodak was late to recognize the problem, slow to react, and then went down the wrong innovation path. It faces many of the problems and is making many of the mistakes that any company can make when so threatened. Because of these delays and missteps, it's still far from clear how Kodak's story will play out. Yet it provides a vivid case study for businesses facing similar challenges. A March survey commissioned by IBM showed that 65% of the world's top CEOs plan on radically changing their companies in the next two years.

Over time, all innovation gets commoditized. In this regard, business models are not different than products and services. So business model innovation must be a perpetual quest for renewal. Look at how Dell, long the PC industry's heavyweight champ, has suddenly become wobbly in the knees. It revolutionized the PC business by assembling computers to order for customers while eliminating the middleman. Now competitors have caught up with Dell's efficiencies and are even undercutting its prices. So Dell is emphasizing designing a better customer experience and selling through retailers.

This reinvention stuff can be a tough slog. "Business model innovation is harder than product innovation. It's harder to visualize, and the scope is larger and much more complex. It includes everything the company does. Everything has to be changed," says Jay Desai, chief executive of management consultancy Institute of Global Competitiveness.

Apple Computer shows how it's done. Here's a company that was trapped in an ever-dwindling niche of the PC business. Then came the iPod, a must-have device for music fans, and iTunes, an online music shop that turned music downloading into a profit-making business. By making iPod and iTunes work with Windows PCs, Apple broke out of selling only to its niche of loyal fans. But its transformation is even more profound than that: In essence, it switched from being a

THE WRONG STUFF: HOW KODAK NEARLY BLEW IT

FOR YEARS, PEOPLE warned that digital imaging would eviscerate film. Rather than embrace the new, Kodak opted for denial—believing its legendary marketing could postpone the inevitable.

KODAK INVENTED the digital camera in 1976 and made the first consumer model in 1994, but lost its lead by hesitating, letting Sony, Cannon, and others grab share, cutting profit margins.

BACKED BY LAVISH spending, Kodak's labs are leaders in digital imaging and inkjet printing. But execs either sat on these breakthroughs or licensed the intellectual property to competitors.

great designer of computer products into a great designer of consumer experiences delivered via devices and services. Now music represents 44% of Apple's revenues, and an even larger share of profits.

Kodak's Perez dreams of replicating Apple's success. "In two to three years, this will be seen as one of the most successful transformations in the history of our country," he predicts. Maybe. Wall Street doesn't share his optimism. Kodak's stock is trading at about 26 per share, down from a high of 95 in 1997. Kodak has been in the red for eight consecutive quarters, losing a total of $2 billion. It hopes its new strategy will get it into the black by yearend 2007.

Many of Kodak's problems can be traced to the successes of its past. Wherever Perez turns in Rochester, N.Y., he is haunted by the specter of George Eastman, one of America's greatest innovators. In spite of the fact that Eastman died in 1932, his mark is still huge on the company he founded in 1880. Decades after his death, it remains difficult to change Kodak's long-established ways. One of them is a hierarchical culture that believes in the omnipotence of leadership. It's so powerful a habit that when Perez came to Kodak from HP in 2003 as chief operating officer, he couldn't get people to openly disagree with him. "If I said it was raining, nobody would argue with me, even if it was sunny outside," he laments.

WATCH FOR TREACHEROUS SHIFTS.

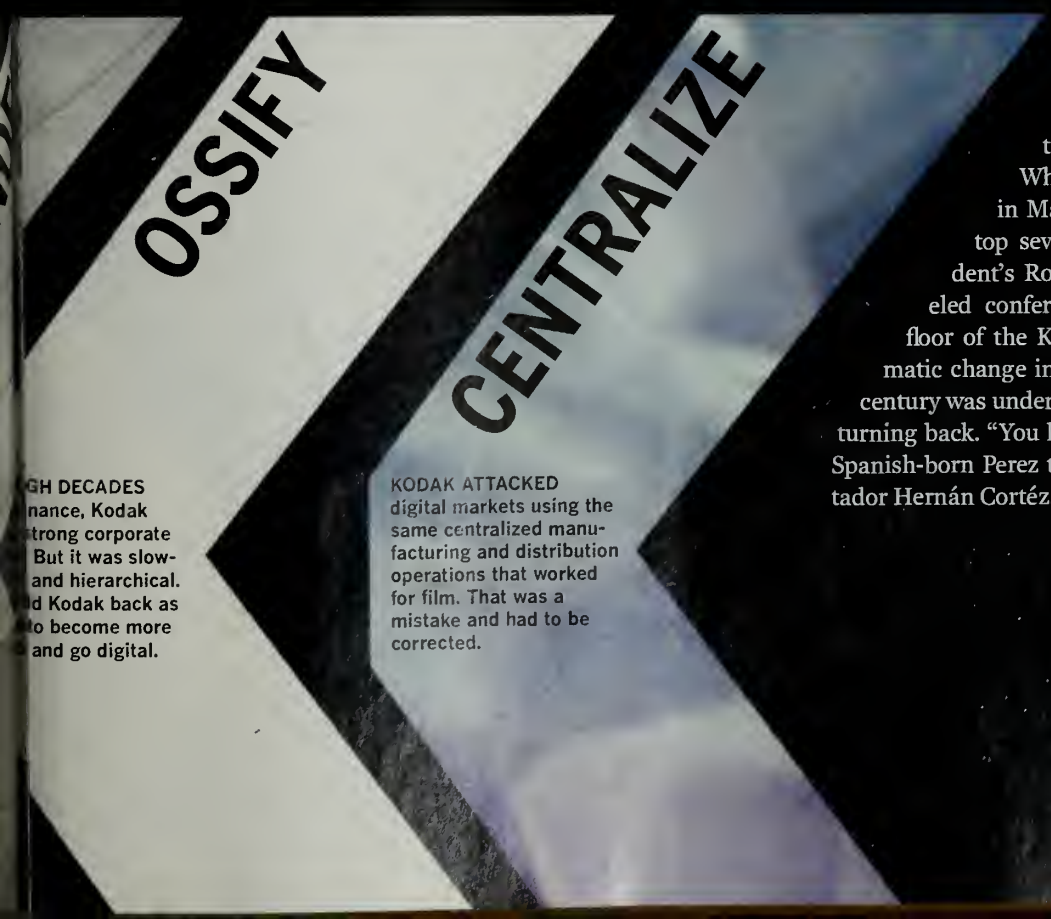
Before Perez arrived on the scene, Kodak was in denial. The company had supposedly been on a decade-long journey to digital technology, yet very little had actually been done. The pressure to rethink the business didn't seem that great. There was no crisis. It wasn't until 2001 that film sales dropped, and even then insiders attributed the financial shocks to the September 11 attacks. The hope was that Kodak might be able to slow the shift to digital through aggressive marketing.

The company hedged its bets and launched an all-out blitz on the digital camera market. Its family of digital cameras, called EasyShare, was widely praised. The company spent a tremendous amount of time and energy studying customer behavior. It found that women in particular loved taking digital photos but were frustrated in moving them to their computers. It was just too hard. Kodak's researchers had found a key unmet consumer need—a huge opportunity.

Once Kodak got its product development machine humming, it cranked out model after model offering consumers top-quality cameras at reasonable prices that made it easy to share photos with friends and family members via their PCs. One of the coolest innovations: a printer dock. Consumers could insert their cameras into this compact device, press a button, and watch their photos roll out.

But there was a fatal flaw in Kodak's strategy. Its executives didn't anticipate how fast these digital cameras would become commodities, with low profit margins, as every competitor raced into the market. Then film really began to tank. Perez had counted on rising demand for traditional photography in China to slow the fall. But China went digital as fast as everybody else.

Perez began investing heavily in digital technologies, shutting down film factories and eliminating 27,000 jobs. He spread the word that Kodak would have to come up with new services and new ways of capitalizing on its technology innovation to boost profit margins. When he was promoted to CEO in May, 2005, he summoned his top seven executives to the President's Room, a spacious, wood-paneled conference space on the second floor of the Kodak tower. The most dramatic change in Kodak's strategy in over a century was under way, and there would be no turning back. "You have to burn the boats," the Spanish-born Perez told them, quoting conquistador Hernán Cortéz.



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KODAK ATTACKED digital markets using the same centralized manufacturing and distribution operations that worked for film. That was a mistake and had to be corrected.

For the new service-oriented business model to work, Kodak had to throw out some of its most cherished notions. No longer would it fool itself that product innovation would be sufficient for it to be successful. And no longer would it try to do everything itself, from manufacturing to selling finished products.

GET YOUR BEST PEOPLE BEHIND THE PROGRAM.

Perez found he had to replace a lot of executives to get the company on a new track. The film-era lifers just didn't get it. Of the company's 21 executive officers in 2003, the year Perez arrived, only three remain. Most of their replacements came from outside Kodak, and most had digital experience.

Perez believes that in any organization, one-third of the staff will readily support a change, one-third can be convinced, and one-third will be unwilling to make the shift. He calls it The Rule of the Thirds. To help him win over a clear majority, he assembled a group of people who were skeptical by nature and assigned them to a committee he called the R Group. ("R" stood for rebels.) He asked them to make suggestions on how the company could be improved. Those discussions contributed to the strategy of coming up with new digital services and new ways of commercializing existing technology. Also, once these people felt like they were part of the conversation for change, they spread the word throughout the organization that Perez was a good leader. And, because they had credibility, their opinions influenced many others.

Other companies haven't been as fortunate. Take Siebel Systems. When the idea of delivering software as a service emerged as an alternative to selling packages of software, Siebel Systems CEO Thomas Siebel threw his weight behind it. Yet even his influence wasn't enough. A watershed moment came when Siebel competed against upstart Salesforce.com for the business of tech giant Cisco Systems. Even though Cisco was tilting toward Salesforce.com, Seibel's sales people pushed traditional product software because they'd get richer commissions that way. Siebel lost the deal, and its business was forced to sell out to Oracle. "There were groups of disbelievers in the organization, which is a recipe for disaster," says Bruce Cleveland, who ran the software-as-a-service initiative.

GIVE YOUR NEW INITIATIVES ROOM TO BREATHE.

A company's core business and its new initiatives are typically at odds with one another. Force them together, and the old business may well smother the new one. Kodak tried it both ways. For two years it placed the digital camera group within its film business so they could share resources and digital could grow more quickly. But last year it split them off again. "One really couldn't piggyback on the other," says Pierre Schaeffer, chief marketing officer for the digital business.

Other companies have scored big by managing their new businesses separately from the start. When Dow Corning conceived of its e-commerce business, Xiameter, the idea was to run it independently. The company didn't want to devalue the Dow Corning brand, which is equated with premium service. Xiameter was about selling large quantities of silicone at low prices with no services attached. Since its 2002 launch, Xiameter has grown to about 15% of Dow Corning's total sales.

MAKE PAINFUL BREAKS WITH THE PAST.

Switching business models requires a thorough rethinking of everything a company does, from planning to manufacturing to marketing. For 120 years, Kodak had done everything for itself. At one time, it even raised its own cattle and used the bones for making photographic gelatin. When it tried to collaborate with others, the results could be messy. For instance, it sought outside expertise from Adobe Systems in 1999 when it was developing a product for transferring consumers' photo prints to compact disks so they could be viewed on PCs. Yet the alliance was fraught with bickering. When Adobe people came up with suggestions, the knee-jerk reaction from Kodakers was "This will never work," recalls Brian Marks, a 19-year Kodak veteran.

Today, Kodak has had a complete change of heart. In early January, Perez and Motorola CEO Edward Zander stood together at the International Consumer Electronics Show in Las Vegas and announced a 10-year partnership in which Kodak would provide chips to operate high-quality cameras in Motorola's cell phones. It was a startling break with Kodak's past. An organization that had always built its own products would now provide technology for somebody else. Kodak will also help consumers transfer images to PCs or online galleries (75% of all photos never leave cell phones).

Perez is gambling that the match will be well worth all the contortions Kodak is going through. He expects much of the growth in digital photography to happen in mobile phones, and he believes profit margins for sensor chips will be twice those of the digital camera business.

In spite of the changes Perez has made, he admits he still has a lot to do. Old habits die hard. At Kodak, it's standard procedure to test a new product or service—and then test and test again to make it perfect, even if that stretches out the journey to the marketplace. Case in point: Kodak has been talking up its Scan the World consumer service for a year, but it's still not sure when or how it will be introduced broadly. The company hopes to sell or lease scanners to photo shops, plus get a piece of the fees charged to customers for the service. Among other things, it's wrestling with the $50,000 cost of the scanner. Will Kodak be able to adjust quickly enough to meet the demands of new and untried markets? Not clear.

ON'T CONFUSE WHAT YOUR COMPANY DOES ITH HOW IT DOES IT.

is taking time for Kodak to understand that it is an image mpany, not a film or camera company. Perhaps it should ke lessons from Western Union. Founded in 1851, the com- ny has managed to ride each successive wave of change in history rather than getting swamped. (A bankruptcy pro- ction filing in the early 1990s was caused by management istakes rather than external threats.) After handling the st transcontinental telegram in 1861, it spotted the oppor- nity to transfer money by wire 10 years later. Then, a series firsts: a city-to-city facsimile service, a microwave com- unications system, a commercial satellite network, and line money transfer.

Why has Western Union been able to adapt to severe dis- ptions and survive over so many years? It never confused e business it was with the way conducted its siness. At its re, Western Union was about facilitating person-to-person communications and money transfers—whether via telegraph, wireless networks, phone, or the Internet. "We always saw ourselves as a communications company," says president Christina Gold. Contrast that with Kodak. By defining itself too narrowly as a product company all those years, it was headed for a fall.

Kodak teeters on the precipice, and with it stand some of the other once-great businesses of the 20th century, from autos to newspapers. They were immensely successful and proud, but their very success made it difficult to adjust. "The more successfully you use a way of working, the stronger your culture is, which is a great strength right up to the time when you need to change," says Clayton Christensen, a professor at Harvard Business School. All innovation is hard. Reinventing your entire business is the hardest innovation of all. IN

RE'S WHAT TO DO—AND WHAT TO AVOID— IEN YOUR COMPANY IS UNDERTAKING A NDAMENTAL BUSINESS TRANSFORMATION

REINVENT OR ELSE

PITNEY BOWES DIVERSIFIED, THEN REFOCUSED ON IT'S STRENGTHS—WITH NEW MAIL-SORTING SERVICES.

RYANAIR EMERGED FROM THE SECOND-TIER TO BECOME EUROPE'S FIRST ULTRA-LOW-PRICE CARRIER.

DOW CORNING SET UP A SEPARATE BUSINESS, XIAMETER, TO SELL COMMODITY PRODUCTS ONLINE.

VERIZON SAW THE NET WOULD HURT VOICE CALLING. RATHER THAN FIGHT, IT LED THE REVOLUTION.

NOVELL'S SHIFT TO LINUX SOFTWARE WAS MARRED BY HEDGED BETS AND MUDDLED MARKETING.

Jeneanne Rae

Rae is the co-founder of Peer Insight, a consulting firm specializing in service innovation and consumer experience.

The Importance of Great Customer Experiences And the Best Ways to Deliver Them

Customer experience is one of the great frontiers for innovation. Although the concept was first invented by Joe Pine and Jim Gilmore in their 1998 *Harvard Business Review* article, most companies have been slow to grasp it. Yet I predict that customer experience will decide the winners and losers in the years ahead. Here's why:

RAVING FANS. Excellent customer experiences are still so novel that, when we have one, we talk about it. Ask anyone who has bought a Mini Cooper. This kind of viral phenomenon creates buzz in the marketplace and generates more revenue than traditional marketing.

LOYALTY. A stable base of existing customers makes it easier to boost both top and bottom line growth. Some 80% of Starbucks' revenues come from customers who visit their stores an average of 18 times a month.

PREMIUM PRICING. Customers will gladly pay more for an experience that is not only functionally but emotionally rewarding. Companies skilled at unlocking emotional issues and building products and services around them can widen their profit margins.

DIFFERENTIATION. The degree of choice in goods and services is bewildering. A history of sustained positive customer experiences increases the chance that a new product gets chosen over its competitors.

Companies that deliver exemplary customer experiences share a set of integrated business disciplines that drive their success. Consider these:

MOMENTS OF TRUTH. Great customer experiences are full of surprising "wow" moments. For customers of Starwood Hotels & Resorts, owner of the "W" and Westin chains, the moment of truth comes when they walk through the door of their hotel room and see the bed. Starwood execs believe that clean, sumptuous linens strike an emotional chord with their clientele, put off by seeing dark-colored, dirty-looking bedspreads. It didn't make financial sense initially to go with fancy bed linens, but the loyalty and buzz they've generated more than justify the expense.

BRAND VALUES. Well-articulated brands are the lodestar of customer experience. In a world of competing alternatives, they provide guidance for customers and managers. Witness Whole Foods Market. Everywhere you look in its stores, the company's brand values are evident: Sell the highest-quality foods, satisfy and delight customers, support communities, promote environmental stewardship, etc. Everything in Whole Foods reflects the brand, leading to a satisfying interaction for each of the chain's customers.

TECHNOLOGY AND PEOPLE. Link information-technology strategy with human resources management. Bottom-line magic can happen when technology is deployed to keep customers happy and coming back. IT can profile the most profitable customers and help managers focus their human resources on keeping them happy. Ritz-Carlton, Progressive Insurance, and Harrah's Entertainment do this.

CO-CREATION. Allow your customers to help create their own experience. You know this phenomenon is at work when people say, "TiVo has changed my life!" Enter a machine that allows you to see what you want when you want it, and bingo! TV is a whole new game wherein the viewer makes the rules. This creates value for discerning people who want television to work for them instead of against them. To cope with the modern world, people want more control.

AN ECOSYSTEM APPROACH. Focus on a constellation of products and services that deliver a seamless, wonderful experience to people. The iPod, of course, is the best example of this approach. The iPod ecosystem includes hardware, software, the iTunes site—first with songs, now with video and accessories—to manage your music or videos.

Building great consumer experiences is a complex enterprise, involving strategy, integration of technology, orchestrating business models, brand management, and CEO commitment. It's harder than you think.

NNOVATIONS IN access

Humana Saw the Future of Healthcare.

Citrix Provided Access.

A man's diabetes is not well controlled, but he doesn't know it yet. Yesterday's healthcare system would have waited for him to call.

Today, as a member of Humana, he may be proactively contacted by a specially trained nurse who will guide him to resources that will help him better understand his illness and improve his self-management skills. It's called the Personal Nurse® Service—a new preventive approach to healthcare for participating Humana members* powered by the Citrix Access Platform.

"Our nurses have the critical information they need at their fingertips wherever they are, thanks to Citrix software. They've already helped 130,000 members be proactive with their healthcare, which means greater member satisfaction."

BRUCE J. GOODMAN
Senior Vice President,
Chief Service and Information Officer
Humana Inc.

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ot all Humana members may be eligible for the Personal Nurse® service This service not immediately activated upon enrollment in a Humana plan.

CITRIX®

inblogs

Jessi Hempel

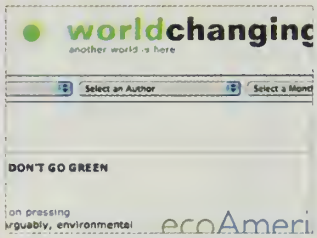
WORLDCHANGING

worldchanging.com

A team of design writers covers environmental, humanitarian, and design issues. They publish tools, models, and ideas for improving life and addressing social problems. Their new book, *Worldchanging: A User's Guide for the 21st Century*, is just out.

EXCERPT FROM SITE

There's a growing movement to create new networking solutions for poverty- or disaster-stricken areas. Green Wi-Fi is one example. Their brief is to use available technologies to create a rugged, low-cost, solar-powered Wi-Fi system for the developing world.... [This fits] into the suite of emerging leapfrogging tools aimed at serving people who not only don't have access to the Net but don't have any of the infrastructure upon which connectivity depends. From the One Laptop Per Child project to Freeplay's Weza and Ubuntu, a compelling toolchest is starting to emerge.



TREEHUGGER

treehugger.com

This Web mag chronicles products and services that have a modern aesthetic and are environmentally responsible. An international staff of roughly 25 writes about green goods and services.

EXCERPT FROM SITE

Hopefully by now you've made a commitment to read labels, purchase organic, and support local farms. (If so, we applaud your efforts to live a greener lifestyle!) However, have you noticed in what type of materials your favorite products are packaged? Purchasing food and other consumer goods with reusable, recyclable, or reduced packaging could reduce your emissions by 230 pounds a year. Knock off another 17 pounds by using your own reusable grocery bag to transport your healthy fare. Carving off pounds [of emissions] while purchasing food—who would've thought?

GRISTMILL

gristmill.grist.org

The Web site of nonprofit grist.org, a Seattle-based online enviro-rag, has provocative commentary, news, and daily dialogue.

EXCERPT FROM SITE

Should traditional wood-framing count as a "green" building technique? Or is something else, such as steel or concrete, a more environmentally friendly choice? Some folks are saying that steel and concrete have the edge: they have more recycled content, can last longer without rot or termite damage, and are easier to reuse or recycle.... CORRiM—the Consortium for Research on Renewable Industrial Materials—has completed a series of exhaustive life-cycle analyses comparing wood-framed construction with competing steel and concrete technologies. Their findings: manufacturing steel and concrete uses lots of energy—lots—and most of it comes from fossil fuels.

INHABITAT

inhabitat.com

Billing itself as a voice for future-forward design for the world you inhabit, this blog tracks innovations in sustainable home design and architecture.

EXCERPT FROM SITE

Spotted at 100% Design this year, Blue Marmalade makes deceptively simple housewares from folded single sheets of recyclable plastic. This translates to sexy objects with low waste in both the production process as well as disposal at the end of the product's life cycle. One of our favorite pieces—the Cog lamp—is made entirely from one single sheet of recyclable material, (including the lamp holder), and is designed to accept energy saver bulbs as well—doubling the eco-friendly quotient. Despite the origami nature of the pieces, the aesthetic is polished and clean—proving once again that the simplest ideas are often the best ones.

ormation & control • building technologies • energy & power • financial services • hearing solutions • home appliances • informa
ting • material handling • medical solutions • transportation • water technologies

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SIEMENS

Global network of innovation

Aili McConnon

Case Study: Access to Justice
Designing a better user experience of the legal system

THE PROBLEM

More Americans than ever before are representing themselves in court, propelled by skyrocketing attorney costs. In big cities, between 70% and 90% of people who go to court for domestic abuse or the loss of their home do so without a lawyer, according to statistics from California and New York. Also, while most courts and legal aid organizations have created Web storefronts where legal forms can be downloaded in seconds, these forms still use complex, often baffling terminology. So people frequently fill them out incorrectly, forcing clerks to redirect and judges to throw out scores of cases.

The government and the legal system are slow to innovate. But a team of both design and law students from the Illinois Institute of Technology (IIT) used the latest methods in consumer-focused design to create a powerful tool: the A2J (Access to Justice) Author. This is an interactive software tool with a dynamic digital guide, a 3D avatar on your computer screen that helps you fill out legal forms. A2J Author makes it cheaper, easier, and faster for Americans to represent themselves in court for divorce, small claims, child support, domestic abuse, and landlord-tenant disputes. Courts and legal aid offices in Illinois and Idaho now use A2J Author, and at least 10 other states plan to roll it out in 2007.

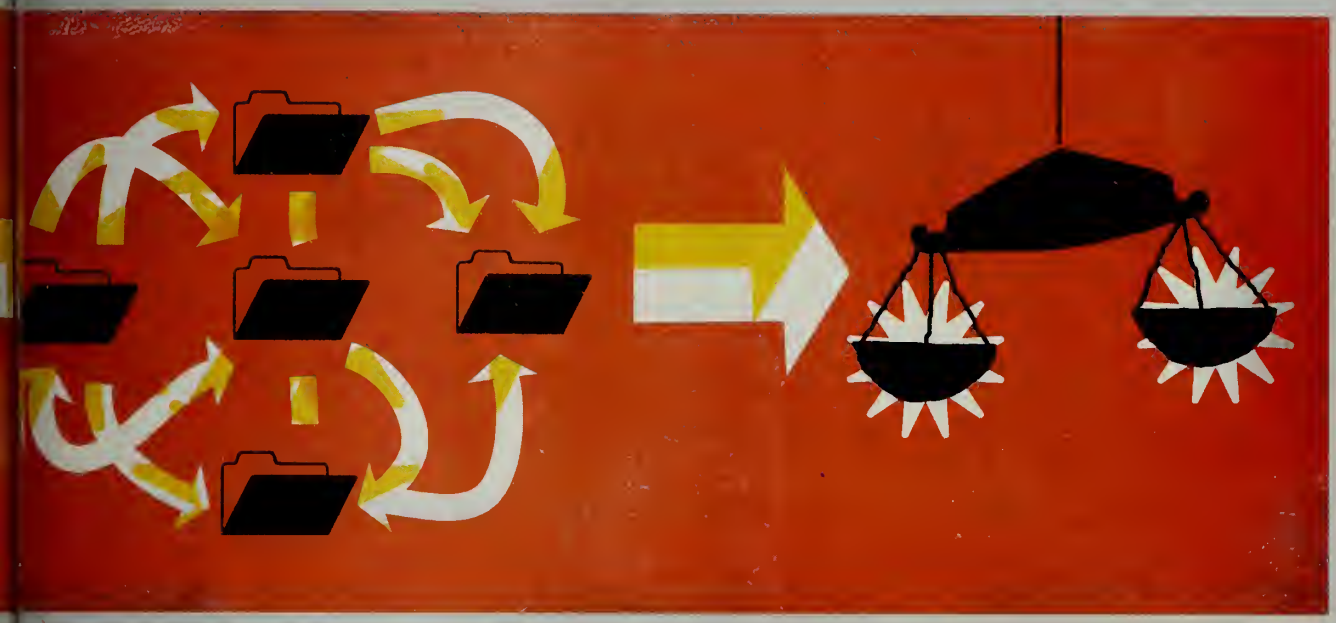
THE RESEARCH

To create A2J Author, the team from IIT first scrutinized how businesses are being reorganized to get closer to customer needs. They wanted to use the same methodology to redesign family and small claims courts to make them accessible to more people. In August, 2000, a group of 13 law students and 5 graduate design students, led by Chicago-Kent College of Law Professor Ronald Staudt, Design Professor Charles Owens, and researchers from the National Center for State Courts started visiting courthouses in Illinois, Colorado, California, and Delaware. "We wanted to stand in everyone's moccasins," said Staudt.

So they arrived before the court doors opened in the morning and spoke with people about why they were representing themselves. They set up camp in the clerks' offices and snapped photos and audiotaped hours of court customers coming in bewildered by divorce forms and eviction papers. They interviewed lawyers, judges, and court staff about the time they spent dealing with administrative confusion instead of processing people's cases.

The team found that the major obstacles to gaining easy access to the legal system were cost and complexity. The cost of lawyers for litigants and the cost of reforming obsolete court systems were very high. The complexity of the legal system, from the jargon-ridden forms to the maze-like courthouses, intimidated many people.

Global businesses are well along in adopting design thinking to shape their strategies, as well as their products. Now governments are beginning to look to design to solve problems in education, transportation, and defense. In the U.S., moving to a customer-centered legal system is making it easier for people to represent themselves in courts.



PROTOTYPING

For the next phase, four law students worked with 18 design students. They split into teams and came up with 59 solutions—everything from a folder that could organize your court papers to a "case card" that could be swiped anywhere in the courthouse to pull up case details and send them to the judge. The card also gives you directions in your own language and helps you pay fees.

Under the guidance of a Chicago design firm, IA Collaborative, the team then combined four of the solutions to create the A2J pilot. Once people click to the A2J home page, the avatar guide—wearing a grey shirt and black slacks—appears. After they enter a name and gender, their individual avatar pops up as well, clutching a virtual case folder. The guide asks a series of questions aloud about family, income, and other salient details. These are also spelled out in a speech bubble. Once the person types in an answer, both user and guide walk to the next question, marked with a signpost on a blue, green, orange, yellow, or pink circle on a road leading to a virtual courthouse. At every step, people can click on any legal term—say, "good faith"—to get a definition in everyday language. Once the pair reach the virtual courthouse, the program puts the responses into the appropriate slots on the legal form and prints out ready-to-file copies. The first prototype the team developed allowed people to dissolve marriages. They tested it in courts in Cook County, Ill. People liked using it.

DISTRIBUTION

In 2006, Idaho started developing A2J Author for all of its court documents. Valley Crisis Center, in Nampa, Idaho, was one of the first places to promote the software. The first client Katrina Rhoades, a case manager, recommended it to was a woman, a victim of domestic abuse. She had little computer experience but was able to use A2J Author. If she'd failed at it, she would have been referred to legal aid. Women in her situation in Idaho typically wait four to six weeks before they can meet with an attorney. While they wait, many often stay in a shelter and need to get a protection order to keep their violent partner at bay. Using A2J Author, this woman filled out her divorce forms in 30 minutes and filed them herself the next day.

The promise of A2J Author is that it's incredibly customizable. Law students and legal aid services staff work closely with judges and lawyers in each district or state to author the scripts and appropriate questions for each type of form. Since all that is needed is a browser, the tool has been in high demand. Someone could be in a soup kitchen or in a hamlet thousands of miles away from a legal aid office and still obtain and fill out the forms needed to file their case. The National Legal Services Document Assembly Server started using A2J because it is a more user-friendly interface to gather and filter data. In 2007, the online guides will speak Spanish and other languages. It could even make it easier to complete tax returns.

Matt Vella

The ENV is the world's first motorcycle built around a hydrogen fuel cell. Running clean and quiet, it is, to date, the simplest and most innovative articulation of that technology's potential

Press the start button and the power source emits a

A motorcycle ride through Bangkok is a nightmare of sound and smoke and speed. In view at any moment are innumerable other belching, squealing two-wheeled vehicles. Similar scents and sounds haunt the streets of Beijing, Berlin, Chicago, Los Angeles, and many other cities the world over.

Now, an all-British collaboration between fuel-cell pioneers Intelligent Energy and design stars Seymourpowell has produced a working prototype that promises a clean, quiet future. Their ENV bike (for "emissions neutral vehicle" and pronounced "envy") is the world's first motorcycle built around a hydrogen fuel cell. It is, to date, the simplest and most innovative articulation of that technology's potential.

Indeed, the ENV is fast becoming one of hydrogen's most attractive and compelling ambassadors, even stealing the spotlight from major auto manufacturers' prototypes. Since its unveiling last spring, the bike has toured the globe, showcasing a compact and practical working hydrogen fuel cell.

Intelligent Energy has been working on commercializing fuel cells for more than a decade and a half. Andy Eggleston, former vice-president for marketing at Ford Europe, was tapped to create a production-ready vehicle based on the company's technology. It had to work, make the case for hydrogen fuel cells simply and effectively, and look, well, irresistible. "The idea was to get a visually striking, technology demonstrator, to show how ready this technology is," says Eggleston.

Seymourpowell, which has produced automotive and motorcycle concepts and production-ready vehicles for BMW, Yamaha, and Jaguar, was commissioned to develop a prototype. Designers and engineers grappled with striking a balance between dual purposes: celebrating hydrogen fuel

The ENV's portable fuel cell, called the Core, produces a kilowatt of power and can run for 4 hours before it needs refueling. It's simple to remove the Core and replace it (far left).

cells as a solution to worsening pollution problems and stirring desire in consumers.

This resulted in a vehicle that is obviously a bike, but one unlike any other that has come before. At 176 pounds, it sits in the band between a heavy-duty mountain bike and a lightweight two-stroke motorcycle. The ENV matches conventionally powered competitors. It can go from a standing start to 30 mph in 7.3 seconds and reaches a top speed of 50 mph. It has a range of 160 miles before refueling. Impressive stats from a bike with zero emissions, except H_2O.

UNUSUAL FREEDOM

Push the ENV's start button and the power source emits a breathy exhale as surplus air exits and enters its chambers and the fuel cell begins producing energy. Missing are the pitching whine and rattling backfire of many modern bikes. Instead, the ENV gives off a low hum. Its body design manages to recast conventional motorbike lines—the high wheel-well arches and forward-leaning posture—in ultramodern materials.

ENV's designers were granted unusual freedom. "Normally, the engine is the given, you draw the bike around it," Talbot says. "But we had the opportunity to distribute power across the entire entity. There are no radiators, there's no big lump of metal in the way."

The most unexpected aspect of its design is that the power source is portable—you can take if off the bike. Called the Core, it is in essence a 1-kilowatt fuel cell the size of a small suitcase. And it can provide power to other devices, at home or in the wild.

The bike's body has an organic look and feel, unlike bikes made by Harley-Davidson or Honda, which proudly display their inner gnarliness with exposed frames, swing arms, chains, metal bolts, and welding. "We want the body to look like it was grown," says Talbot.

Though the ENV is still a high-concept prototype, there's no technical reason why it can't be built today. Getting the cost right is the key. Given its simplicity and versatility, the ENV could do for hydrogen technology what the Prius did for gas-electric hybrids.

sound like breathing before settling into a low hum

indata

Aili McConnon

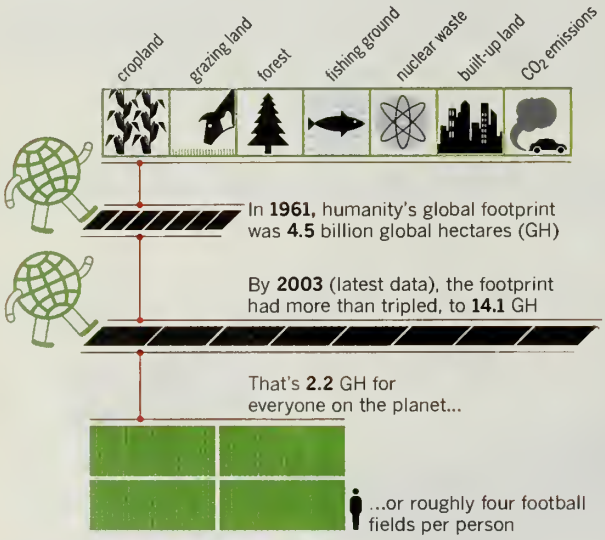
WHAT'S YOUR ENERGY FOOTPRINT?

We now demand more of the planet than it can supply us. This imbalance is spurring rapid advances in renewable energies, which are becoming economically competitive with fossil fuels. Take a look at where we are now and where we're headed.

THE SITUATION

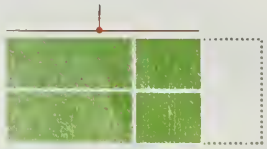
Ecological Footprint: how much land and sea we need to generate the resources we consume and to absorb the waste we create.

Components of the footprint:



THE PROBLEM

1. While our footprint is **2.2** GH, the planet can actually only supply each of us with **1.8** GH to generate resources and absorb waste...



2. ...so humanity is depleting the planet by **25%**; by 2050 it will be **50%** if there is no change

ONE SOLUTION: RENEWABLE ENERGY

Annual global investment in new renewable energy has risen almost sixfold since 1995 with cumulative investment at nearly $180 billion. New renewable energy capacity is currently 4% of world energy.

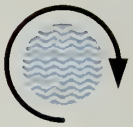
Since 2000, **wind energy** production has more than tripled

Since 2000, **solar energy** production has increased sixfold

Since 2000, **fuel ethanol** production (from crops) has more than doubled

Since 2000, **biodiesel** production (from plant oils) has expanded fourfold

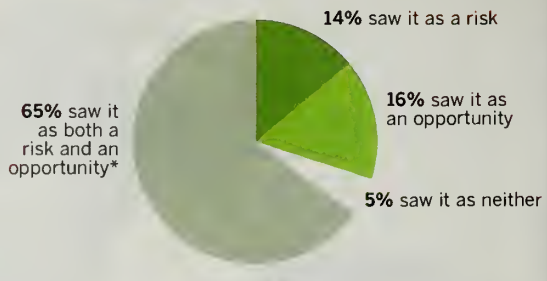
Since 2000, **compact fluorescent light bulb** production has tripled (conservation)



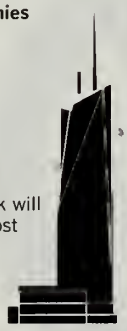
Hydro capacity will increase 63% between 2002 and 2030

CORPORATE PERSPECTIVES

1. **How 92 companies (from a variety of sectors) view public concern about greenhouse gases:**

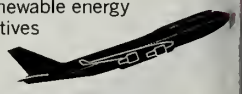


2. **What two companies are doing:**



The new **Bank of America** Tower in New York will be the world's most environmentally sound skyscraper

Virgin Group CEO Richard Branson created Virgin Fuels, which will invest $3 billion over ten years in renewable energy initiatives



Data sources: WWF, Zoological Society of London, Global Footprint Network, WorldWatch Institute, REN21, International Energy Agency, Conference Board, Pew Center on Climate Change, compani
*Cost saving is enhanced reputation

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ucing Relate.™ Intuitive ergonomics in a durable framework for a lifetime of comfort. Body Adaptive Control™ Quick Tension™ lever allow you to easily adjust to any position. Spoil yourself rotten at AllsteelOffice.com/rel.

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Media's Favorite Control Freak

Alan Patricof has put many a tech star on the map. He's back in early-stage VC, ornery as ever

Y MARA DER HOVANESIAN

WHEN A COLleague suggested to tech entrepreneur J. Scott Hamilton that he tap venture capitalist Alan J. Patricof for oney, he thought to himself: "You've t to be kidding." Hamilton had no siness plan and paltry sales, but like ost upstart CEOs, he was hungry for nding. He landed an appointment, d just 15 minutes into the presentan, Patricof "stood up, said, 'We can do is deal,' and walked out of the room," calls Hamilton. Since the April, 2004, counter, Hamilton has gotten $1.7 miln from Patricof and $3.3 million from alt Disney Co. "It forever changed the ospects of my company," he says. "I d instant credibility."

The often gruff Patricof has bruised ny an ego with his abrupt exits over the rs, but his well-timed entrances have de him one of the world's most sucsful venture capitalists. Having backed L, Cellular Communications, and Apple mputer over a 30-year career, he is now king trendsetters of the digital media . In Hamilton's case, Patricof saw a mpany that manages listener lines for e 250 radio stations but also could an advertising channel for call cen- services and directory assistance. His tincts are right so far: The company, dooVox, has revenues of $8 million, from $800,000 two years ago.

Such small and promising ventures ve been increasingly out of reach for ax Partners, the firm Patricof founded 1969. At $19.4 billion under manageent, it has morphed into a buyout firm her than one that invested in earlygers. Seeking to return to his VC roots, tricof in March launched Greycroft rtners, a $75 million fund that's already made five investments of $500,000 to $3 million. So far he's bought into blogs (PaidContent.org, The Huffington Post), social networking (TAKKLE Inc., the first online social network for high school sports), and digital entertainment (Pump Audio, a music software producer), among other things.

'TRIPLE-A PERSONALITY'

A MILLIONAIRE MANY times over, he isn't in it for the money. "It's a disease," says the 72-year-old Patricof. A self-styled "triple-A personality," he's looked at some 200 prospects in the past six months and hired three seasoned VCs to help find more. "The VC mantra has been 'We don't do deals under $5 million,'" he says. "[But] I don't care how small it is. I'm going back to the model I created. The idea is to build a company and stay with it."

Still, Patricof isn't seeking fresh startups. "He likes the mechanics of the business to make sense," says Steve Ellis, CEO of Pump Audio, Greycroft's first investment. Pump was founded six years ago to supply the advertising and TV industries with music tracks made by independent artists with no royalty constraints. A catalog of more than 75,000 songs, all original, supplies 16 MTV channels, Nickelodeon, Discovery, and other major networks. Besides the bankroll, Patricof has been pivotal in making Ellis some high-profile introductions. "There isn't anybody in the media space who doesn't know Alan," he says.

HANDS-ON Patricof believes in building companies and staying with them

Patricof's name opens doors beyond investing, too. A friend of the Clintons, he has served as Hillary's campaign finance chairman since her initial bid for New York senator. He also advises the World Bank's International Finance Corp. and the African Venture Capital Assn.; in two years, he has logged a dozen trips to locales from Mali to Nigeria.

But his first love is media. An original backer of *New York* magazine, he now sees the Net as ripe with potential. Blogger Rafat Ali, founder of PaidContent.org, was heavily courted by VCs who wanted "far too big of a chunk of the company," says Ali. But the $1 million or so he says he got from Patricof secured his independence—even from Patricof. Case in point: On Aug. 4, Ali posted a scoop about an M&A deal involving a company with which Patricof has ties. Patricof "went ballistic" and pressed Ali to reveal his sources, says Ali. "I said, 'Look, I am not going to tell you.' Then after he told people, 'Rafat did a great job.' He understands the boundaries."

Patricof also lit a fire under Ali to assemble a board and extend the brand. "We like that business a lot, and we've already noticed a lot of interesting changes since Alan made his investment," says Reed Phillips, managing partner of the New York media investment bank DeSilva & Phillips.

Patricof has had his critics over the years. "He's very, very smart, but a complete control freak," says media writer Michael Wolff, who roasted him in his 1998 book *Burn Rate*. "He's made an enormous amount of money using what I'd call the brass knuckles method of investing." But VoodooVox's Hamilton gladly suffers Patricof's shortcomings: "He has a style that some interpret as brusque... but when someone of Alan's stature tells you something, you listen."

–With Heather Green in New York

A Dicey Win for Blackstone

The bidding war over Freescale went to the private-equity powerhouse and its partners. But the chipmaker's debt load may jeopardize its future

BY EMILY THORNTON

IT WAS A QUICK BUT BRUTAL skirmish between private-equity titans, but it said a lot about the state of the buyout business. On Sunday, Sept. 10, a team of four firms led by the Blackstone Group was putting the final touches on a $38-per-share bid for a major industrial company. All of a sudden, a rival quartet led by Kohlberg Kravis Roberts & Co. swooped in and suggested they might be willing to pay up to $42. Flush with cash, buyout firms have begun gobbling up companies everywhere in sight, often busting in on each other's deals. The surprising thing about this bidding war was the spoils: Austin (Tex.)-based Freescale Semiconductor Inc., one of the world's largest players in the semiconductor industry, hardly a province for buyout barons.

On Nov. 13 the Blackstone crowd prevailed when Freescale shareholders signed off on its $17.6 billion offer, paving the way for the largest tech buyout ever. The $40 per share that Freescale ultimately accepted was a steep premium for a company that traded at $30 before the deal and just $13 after being spun off from Motorola Inc. two years before. "The deal was a shock," says veteran semiconductor analyst William I. Strauss at research firm Forward Concepts Co. in Tempe, Ariz.

The semiconductor industry is unstable and demands lots of capital spending to keep up with rapid technological changes. In that kind of an environment, debt—the lifeblood of buyout firms—can be dangerous. Someday Blackstone, Texas Pacific, the Carlyle Group, and Permira Advisers might look wise for paying up for one of the few chipmakers large and strong enough to be a survivor, and a potential acquirer, in an industry ripe for consolidation. But there are many risks (table), and the deal could just as easily turn out to be a bust.

The most pressing question for the buyout firms is whether Freescale c thrive despite the $9.5 billion in debt must take on for its owners to pay for t deal. Freescale's interest expense pa ments are expected to zoom to more th $750 million, vs. $105 million paid in t 12 months ended in September. "Becau this is funded with so much debt, it is o of the riskier deals in tech land," says son Pompeii, an analyst at Fitch Ratin When the buyout was confirmed, Fit downgraded Freescale's existing de from investment grade to junk status.

Freescale's management team a Blackstone's group declined to co ment for this story, citing regulat restrictions. When asked if the deal w risky, Freescale board member Steph P. Kaufman said: "That's an issue for t buyers." The board, he says, was focus on getting a good price for shareholde

Right now it looks as though the bu ers have some breathing room; Freesc generated $780 million in cash last ye But the firms are expected to cart

but $600 million of the $3 billion cash on the balance sheet to pay for the deal. Moody's Investors Service estimates that Freescale will generate only $50 million in free cash in 2007. Value Line reckons net income will shrink to $50 million, from $930 million. "The company will have less flexibility to fund growth plans," says Moody's analyst Gregory A. Fraser.

The debt load also leaves precious little room for error in the event of an industry downturn. In the semiconductor industry's last severe bust, in 2001, Freescale, then Motorola's chip division, lost $2.2 billion. It began to slash its workforce by one-third and shuttered more than half of its manufacturing facilities to reduce fixed costs. When the red ink kept flowing, Motorola spun off the business and brought in Michel Mayer, a general manager at IBM Microelectronics, to be the new company's chief executive. He quickly set about making Freescale lean and mean. Profit margins rose by 10% in two years, and it regularly beat analysts' quarterly earnings estimates. "Had the private-equity firms leapt in right after Freescale went public, I could see where they would have recognized the value in the turnaround story," says Doug Freedman, an analyst at American Technology Research Inc. "But they're stepping in after the company has been raising its numbers many quarters in a row."

UNDERAPPRECIATED PLAYER

COST-CUTTING ALONE can't work forever. Freescale's sales increased by only 2.4% in 2005 as the revenues of chipmakers overall rose by 5.7%, according to tech industry researcher Gartner Dataquest. In early 2006, executives began to examine their strategic options, which included buying the semiconductor business of Amsterdam-based Royal Philips Electronics and merging with another company, according to company filings with the Securities & Exchange Commission. In May, Blackstone contacted Mayer to see if Freescale would be interested in a deal, and going private was added to the list of possibilities.

The buyout firms led by Blackstone were interested in Freescale because they perceived it to be a crucial player in an industry growing faster than the overall economy. They also believed public investors weren't recognizing the improvements it had made or appreciating its position as a leading supplier of chips to a wide variety of products in the electronics industry, from cell phones to cars.

And the group thinks the chip industry itself is changing in a fundamental way. According to sources close to the deal, they expect it to experience slower growth and less volatility as chips become incorporated into a wider range of products. As a result, they reason, Freescale won't have to burn through cash to fund rapid expansion, and will be able to handle more debt on its books. That assumption makes the deal seem more like a classic leveraged buyout, in which a firm seeks out steady cash flow.

But Freescale needs to do more than stabilize its cash flow to make the buyout work for its new owners—it needs to grow. One way to do that is through acquisitions. Citigroup analyst Glen Yeung recently issued a report speculating that Freescale might buy other chipmakers or chipmaking units like STMicroelectronics to transform itself into a Texas Instruments Inc.-like business with scale.

Buyout firms do know a thing or two about rollup strategies. Still, bidding wars often push buyers to make offers they later regret. Consider that in July Blackstone offered just $35.50 to $37 per share for Freescale while it was pursuing the semiconductor business of Philips Electronics, according to filings. By the time the KKR group pounced on the possibility of buying Freescale on Sept. 10, Blackstone's group was about to nab it for $38 a share. On Sept. 14, Blackstone's crowd put in a "best and final" offer of $40 that would expire the next day at 10 p.m. The offer permitted Freescale to seek higher bids for the following 50 days. None emerged. ■

Can It **Work?**

Why the $17.6 billion buyout of Freescale Semiconductor is fraught with risk

SCALE

It's the biggest tech buyout ever and the biggest deal by far in the chip sector, which requires heavy capital investment.

PRICE

The four private-equity firms paid more than they initially valued the business at in order to beat rival bidders.

EFFICIENCIES

Freescale had been cutting costs for years. Its new owners must generate returns by boosting sales. That's no easy task in an industry growing at a snail's pace.

INSTABILITY

Freescale's owners are betting that the notoriously cyclical chip industry will stabilize as chips are incorporated into a wider range of products. That may not pan out.

Data: *BusinessWeek*

Did the Election Spur a Drug Deal?

Why the Democrats' plans for health care may be behind CVS's bargain buyout of Caremark

BY AARON PRESSMAN

THE $21 BILLION QUESTION that investors have been asking since drugstore giant CVS Corp. announced a merger with pharmacy benefits manager Caremark Rx Inc.: Why did Caremark sell when its stock is so cheap? On Nov. 1, CVS offered 1.67 shares for each Caremark share. After CVS stock sank 7% on the news, that worked out to about a $48 per share, or a $21 billion deal. That's no premium for shareholders of Caremark, which was trading at 49 at the time, more than 20% below where it was two months ago.

Many analysts haven't bought the argument of Caremark Chief Executive Edwin M. "Mac" Crawford that the combined entity, leading both the drugstore and mail-order prescription markets, will revolutionize the way customers get their meds. Some say the deal was rushed after Wal-Mart Stores Inc. announced a drug discount plan in Florida on Sept. 23, threatening Caremark's heady 200% increase in profits since 2003. But Wal-Mart's relatively small effort wouldn't hurt Caremark's bottom line for years. "Why does Caremark think they need to change the model?" asks A.G. Edwards & Sons Inc. analyst Andrew L. Speller, who is now questioning his own growth assumptions about the company. Even more puzzling, Caremark bought back almost 2 million of its own shares at an average $55 price in the third quarter. So why sell now?

It appears that Crawford's bet is as much political as it is strategic. At the time the CVS deal was negotiated, the Democrats were rapidly surging in the polls. And a Democratic Congress figures to be inhospitable for Caremark and the other pharmacy benefits managers (PBMs). With politics clouding future earnings growth, Crawford is selling "at the top of the cycle," says David D. Halbert, former CEO of AdvancePCS Inc., one of the nation's largest PBMs when it was acquired by Caremark in 2004. Crawford and CVS declined comment.

Near the top of Democrats' agenda is an overhaul of the Medicare "Part D" prescription drug benefit. It's well known that B Pharma would suffer from this initiativ But what has been less widely appreciat is the impact it would have on middlem such as Caremark. The aim of an attack Part D would be to lower the price of dru paid for by the government while reduci the need for the hundreds of complicat private plans offered by Nashville-bas Caremark and its competitors.

CHANGE OF PLANS?

INDEED, PART D was a big reason Car mark surged to the No. 3 spot on t BusinessWeek 50 list of top corpora performers. The company's SilverScri Insurance unit signed up more th 400,000 seniors by May 1. Combin with the behind-the-scenes servic Caremark performs for plans of oth insurance companies, it's among the biggest Part D plan providers.

Republicans explicitly barred the go ernment from negotiating with drugma ers in the original 2003 law. Instead, ea of the hundreds of plan sponsors, inclu ing Caremark's SilverScript, cuts its o deals with the drug companies. PBI then receive a percentage of those pri for administering the program to co sumers, plus rebates from manufact ers. Caremark's revenue from retail dr claims rose almost 18%, to $6 billion, the third quarter alone, due in large p to its Medicare Part D customers.

The Democrats' plan, according Vicki Gottlich, an attorney at the no profit Center for Medicare Advoc Inc., is to allow seniors to sign up a single government-sponsored dr plan that would compete with all of t hundreds of private plans. If the gove ment plan could offer lower prices a less complexity, it might win custom and prompt other federal and state p grams to follow suit in th own pharmaceutical ass tance programs, says Halb Government spending counts for about 40% of d sales. A move by Medicare negotiate prices directly "I the potential of changing industry," Halbert says.

The BusinessWeek 50 — The Best Performers

It may be that Woonsocket (R.I.)-ba CVS, which hit No. 39 on the BusinessW 50, is getting a bargain. The deal wo create a sizable competitor, and scale help since Wal-Mart has started to th its weight around the pharmacy sec Still, CVS and Caremark will have to ta with a foe that has even more muscle t Wal-Mart—a Democratic Congress. ■

–With Robert Berner in Chic

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How Bill Clinton Helped Boost CEO Pay

A law he championed to curb compensation has backfired—and pay packages have exploded

BY KEITH EPSTEIN AND EAMON JAVERS

BILL CLINTON HAD WHAT he thought was a great idea to curb the soaring paychecks of the nation's executives. It was 1991, shortly after the launch of his Presidential campaign, and he had just read a best seller on corporate greed by compensation guru Graef Crystal.

Clinton's brainstorm: Use the tax code to curb excessive pay. Companies at the time were allowed to deduct all compensation to top executives. Clinton wanted to permit companies to write off amounts over $1 million only if executives hit specified performance goals. He called Crystal for his thoughts. "Utterly stupid," the consultant says he told the future President.

THE SHAME GAME

NOW, 13 YEARS AFTER Clinton's plan became law, the results are clear: It didn't work. Over the law's first decade, average compensation for chief executives at companies in Standard & Poor's 500-stock index soared from $3.7 million to $9.1 million, according to a 2005 Harvard Law School study. The law contains so many obvious loopholes, says Crystal, that "in 10 minutes even Forrest Gump could think up five ways around it."

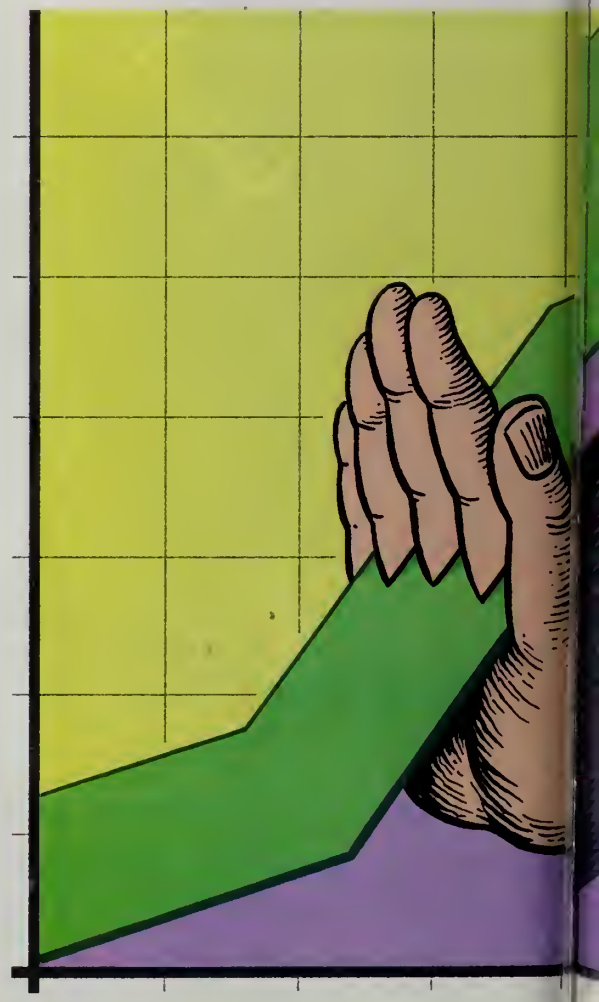
From the Internal Revenue Service to corporate boardrooms, Clinton's remedy has become the biggest inside joke in the long history of efforts to rein in executive pay. It has allowed companies to take deductions for executive pay tied to goals as vague as "individual achievement of personal commitments" (BellSouth Corp.) or improving "customer satisfaction" (Dell Inc.). Energy giant AES Corp. for a time demanded that its top people maintain a workplace that was "fun."

"We were trying to shame companies into changing their behavior," says former Clinton senior adviser Bruce Reed. "And companies have been shameless in ignoring what we did." Or perhaps just astute in exploiting the flimsiness of Section 162(m) of the IRS code, as the measure is formally known. Reed acknowledges that the Clinton team deliberately watered down the proposal to make it more palatable by, for example, not applying the performance requirement to the award of stock options. Clinton did not return calls for comment.

As the Democrats prepare to take control of Congress, 162(m) is likely to come under intense scrutiny. The Securities & Exchange Commission has already announced it will require greater disclosure of executive pay beginning in 2007. On Oct. 23 a coalition of 25 pension funds with $850 billion in assets formally demanded more information about the sort of advice compensation consultants provide to ExxonMobil Corp. and 24 other corporate giants. Meredith Miller, assistant treasurer for policy of Connecticut's state employee pension plan, says 162(m) is one of the investor coalition's main concerns. "We've become more sensitive to the gaming" of pay rules, she says.

Soon after the Clinton idea was enacted in 1993, compensation and tax advisers announced that they'd found ways to get around it. "It is unlikely that 162(m) will cause corporations to lower executive compensation levels," lawyer George A. Villasana wrote in the February, 1995, issue of *CPA Journal*. Currently the senior corporate counsel at AutoNation Inc., the country's biggest car dealer, Villasana observes that "companies have done exactly what I predicted."

Michael S. Melbinger helped turn Villasana's prognostications into reality. Melbinger heads the executive compensation practice at the Chicago-based law firm Winston & Strawn. His clients include Boeing, Discover Financial Services, and the New York Stock Exchange. "I don't want to give away my secrets," Melbinger says, "but I can figure out a completely legal way to structure most all compensation to fit within the 'performance-based compensation' exception of Section 162(m)." As a practical matter, the law's requirement of performance criteria for deduction of pay above $1 million quickly established $1 million as the minimum base pay any sel



pecting CEO expected from a major poration.

Members of compensation committees he boards of four of the nation's larg- corporations told *BusinessWeek* that (m) is merely a nuisance that hasn't pped them from paying executives atever they consider fair. All of these ectors requested anonymity for fear osing their positions. Companies are der no legal obligation to disclose how y comply with 162(m), and as a result, roud of secrecy surrounds the topic.

NDING THE RULE

OK, THIS THING does not work," IRS official says about the rule. In 04 the tax agency audited compli- e at 24 companies and found that 23 l failed to comply with at least one uirement of 162(m). Among the fail- s: not getting shareholder approval performance goals. The agency says it ontinuing to monitor how companies eneral comply with the rule. But the cial confirms that a corporation that efully navigates the provision's loop-

holes has little to fear.

One perfectly legal way to follow the letter of 162(m), if not necessarily its spirit, involves listing dozens of performance categories, keeping many hopelessly vague. A board's compensation committee can choose any one or a combination of the goals to measure an executive's performance. This laundry list often sounds responsive to shareholder concerns and seems to establish direct links with financial performance. The list may suggest, for instance, that an executive will be judged on "earnings per share" or "operational revenue." But how much in earnings or revenue? Such details are worked out in private by the compensation committee. BellSouth declined to comment on its board's application of the goal "individual achievement of personal commitments." Dell similarly didn't want to explain how it calibrated "customer satisfaction."

During Dennis Bakke's tenure from 1994 through 2002 as CEO of Arlington (Va.)-based AES, which operates power plants, his performance goals included maintaining a "fun" workplace. One way the board measured the fun quotient was with an annual employee survey. (Sample question: "How well do you believe AES people company-wide are doing in relation to the four principles listed below: fun, fairness, integrity, and social responsibility?")

"To some, it's soft," Bakke says of the focus on fun. "To me, it's a vision of the world." Targets set by other corporations are no more rigorous, he argues. "They all pretend to go through these metrics," he says. But "pay is determined by competition, by the market, by what the board wishes to pay, plain and simple."

Bakke, who was paid stock options valued at more than $9 million in his final year with AES, also was evaluated based on goals such as the successful financing of subsidiaries and ensuring that employees demonstrated "social responsibility." Today Bakke, 61, heads a nonprofit that runs charter schools.

Washington Watch

Executive pay is getting more scrutiny in the capital

SEC

The agency will enforce new rules in 2007 requiring increased disclosure and justification of executive compensation

IRS

Auditors are monitoring compliance with Clinton's tax law because of suspicions that some companies are abusing the write-off

CONGRESS

Newly empowered Democrats will look for ways to rein in huge pay; Republicans have already said the existing law doesn't work

Another way companies can reward executives in a tax-friendly manner, even when performance falters, is to set aside an inflated pool of money for such compensation. To qualify for a deduction, companies must set a maximum sum for compensating their top five officers. Many companies set aside more than they are likely to pay. If executives fail to meet certain performance goals, the company can still award lucrative (and deductible) bonuses by reducing compensation below the make-believe maximum.

Liz Claiborne Inc. in 2003 decided to cap total compensation of then-CEO Paul R. Charron at 200% more than his $1.3 million salary. Because Charron failed to meet some performance targets, the apparel company's compensation committee awarded him a bonus of $1.7 million on top of his salary—not the maximum amount, but a lot of it. Raul Fernandez, the CEO of ObjectVideo Inc. and chairman of the Claiborne committee, says: "You have to create frameworks that create the maximum amount of flexibility, deductibility, and getting the right amount to the person."

When all else fails, some companies simply ignore 162(m), forgo the tax deduction, and pay executives whatever the board wants. Scott McNealy, former CEO of Sun Microsystems Inc., has benefited from this approach. In addition to his base salary of $121,789, he was paid a $1.1 million bonus in 2005, even though the company was forced that year to restate earnings from earlier periods. McNealy failed to meet 162(m) performance goals such as achieving strong operating income and earnings per share, according to Sun's 2005 proxy statement. Presumably that meant Sun couldn't deduct the bonus, though the company won't comment on that. But Sun had other reasons for paying McNealy the extra money, says company spokeswoman Jennifer Farris: "employee retention," or keeping McNealy from leaving. Replaced as CEO in April and now serving solely as chairman, McNealy didn't return phone calls. ■

It's Miller Time In China

SABMiller's Snow beer is flooding the country's rural regions

ROLL OUT THE BOTTLES Snow breweries are in less expensive areas

BY ADRIENNE CARTER

AFTER SABMILLER LOST a bidding war for China's Harbin Brewery Group to Anheuser-Busch Cos. two years ago, it looked as if America's King of Beers would reign over the Middle Kingdom as well. Anheuser-Busch, after all, had already sealed a deal with China's leading brewery, Tsingtao, and with Harbin in its stable it looked unbeatable.

But SABMiller had a Plan B that could well give it the throne after all. Since losing Harbin, London-based SAB has focused its energies on a 12-year-old joint venture, China Resources Snow Breweries Ltd., that is now thriving. In June, CR Snow, which includes 46 breweries across the country, surpassed longtime leader Tsingtao for the No.1 spot. For the 12 months through June, CR Snow produced nearly 40 million barrels, vs. 37 million for Tsingtao. As a result, CR Snow boasts 14.9% of the Chinese market, compared with Tsingtao's 13.9%. "Our growth has been on the back of a very consistent and targeted strategy," says Wayne Hall, SABMiller's finance director in China.

Both companies want to be the toast of China. As beer sales in the U.S. and Western Europe have lost their fizz, they're growing at 8%-plus annually in China. That has helped China overtake the U.S. as the world's top beer market.

SAB was early to see the promise of China, where it has been brewing since 1994. Yet instead of targeting big cities such as Shanghai and Beijing, as its competitors did, SABMiller scoope up breweries in less affluent area including the northeastern rust be and the populous inland province Sichuan. This contrarian strategy ha allowed SABMiller to build up a na tional footprint at bargain prices. Whi Anheuser ponied up $700 million—a much as $62 per barrel of annual brew ing capacity—for Harbin, SABMiller ha typically paid $30-$40 per barrel fo its breweries. "SABMiller has made mint by purposely buying cheaper a sets," says Bear, Stearns & Co. analy Anthony Bucalo.

SABMiller has been smart in its po sitioning of the flagship Snow bran To appeal to upwardly mobi youth, it slapped a shiny, mo ern label on the 50-year-o brew and launched a nation ad campaign emphasizing th beer's freshness, complete wi sweepstakes that reward wi ners with outdoorsy vacatior The marketing push is payin off as it presses into the b cities. China now accounts f nearly 20% of SABMiller's to beer volumes, and Snow h become China's No.1 bran Soon, it will probably surpa Miller Lite as the biggest sell in the company's cooler.

BUD'S COMEBACK

ANHEUSER remains a form dable foe. If you factor in Ha bin and its own Budweis the brewer remains bigg than CR Snow in China. century-old Tsingtao is a l player in the premium segment, wh profits are plumper, and it plans to national with Harbin, currently conce trated in the northeast. "We have m of a premium portfolio, which at the e of the day is how you're going to mak in China," says Stephen J. Burrows, C of Anheuser-Busch International.

Both companies, meanwhile, co be tripped up by China's fra mented market, where r taurants, not supermarkets liquor stores, account for lion's share of beer sales. byzantine distribution syst pinches profits and makes tough even for internatio heavyweights to dictate pric and influence how their be are displayed. ■

> China has overtaken America as the top beer market

–With Bruce Einh in Shang

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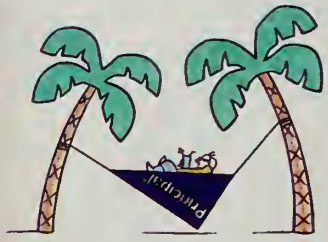

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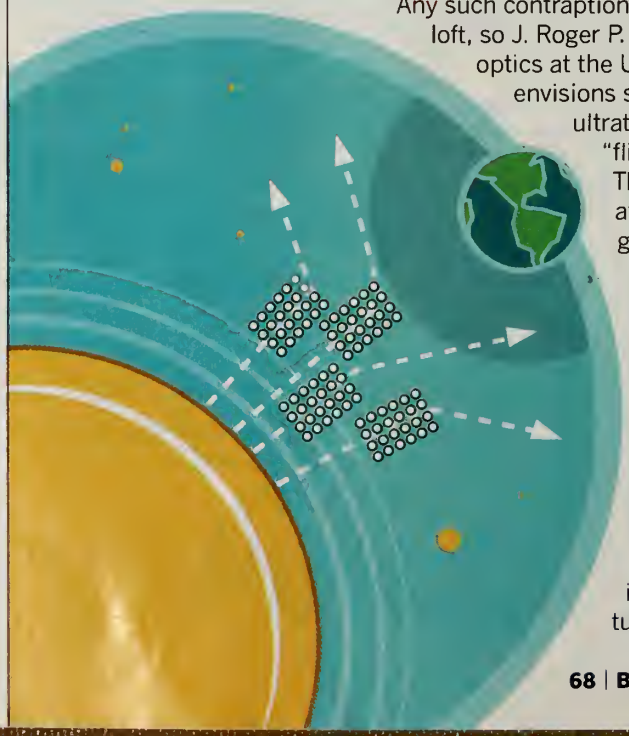
Wild Fixes for A Warming Planet

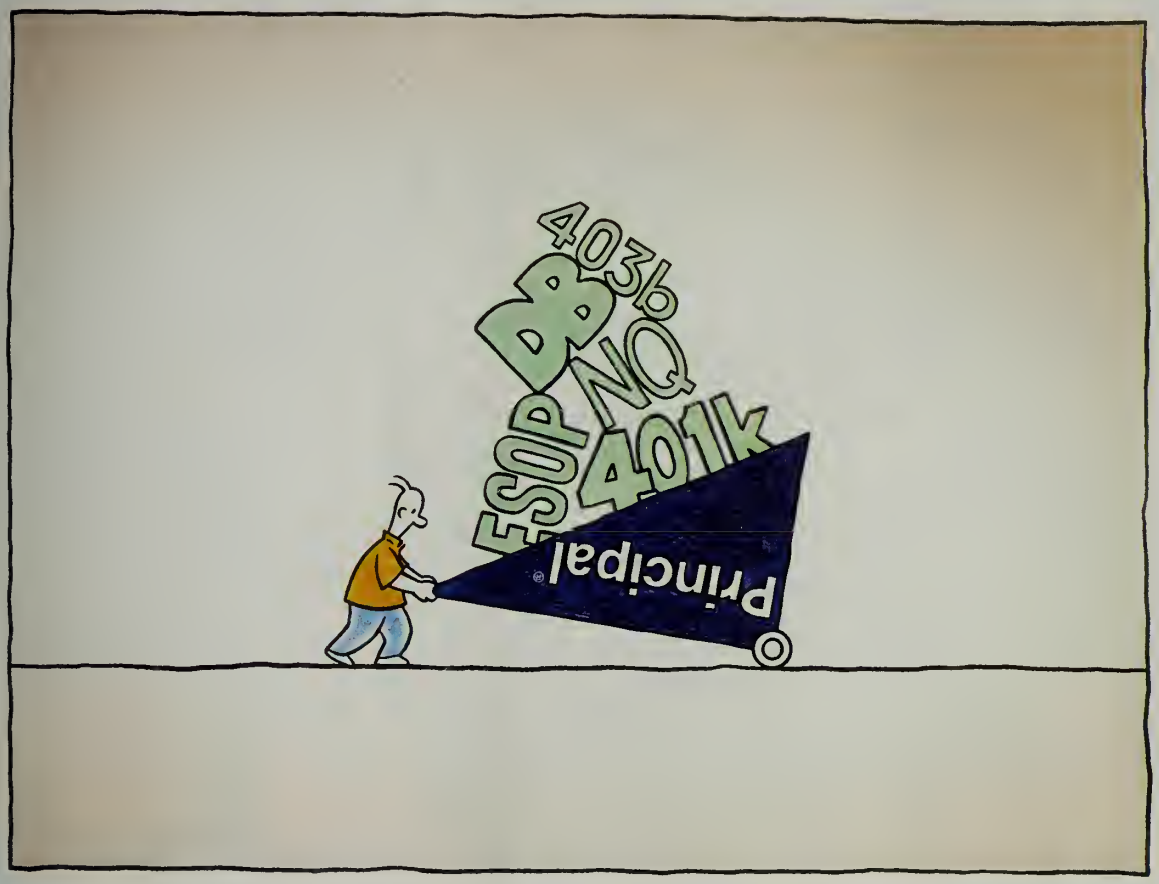
Scientists are envisioning giant but risky engineering projects to undo climate change

BY ADAM ASTON

If fossil fuel technologies got us into the global warming crisis, ca technology get us out? Scientists say massive, planet-saving inte ventions are possible, but they aren't for the faint of heart. Efforts "geo-engineer" earth, they warn, will incur staggering costs and po risks as unpredictable as global warming itself. "Cutting carbon mu come first," says David Keith, an energy expert at the University of Calga "To think of geo-engineering as a solution is ludicrous." Still, even Kei agrees that, in a worst-case scenario, big fixes may be needed. Arctic ter peratures in recent years have risen about three times faster than the wor average, stoking fears that sea levels might climb rapidly. The loomi costs of climate change in terms of lives, land, and infrastructure lost cou eventually justify extraordinary acts. Here are some proposals—and risk



1 SOLAR SHADE Scientists have long toyed with the idea of orbiting a huge mirror around the earth to block the sun's rays. Any such contraption would be too heavy to loft, so J. Roger P. Angel, a professor of optics at the University of Arizona, envisions shooting trillions of ultrathin, lightweight glass "fliers" into space instead. The discs would be aime at a sweet spot where the gravitational pull of the sun is equal to that of t earth. They would refra just 2% of sunlight—t little to notice on the ground, but enough t offset a doubling of C levels. Angel propose using exotic magnetic launchers to shoot bins of fliers into orbit **Risks:** Huge costs, plus it would be impossible t turn off the shading effec



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IDA IRELAND

2 ALGAE FARMING In the same way that trees are planted to capture CO_2, algae growth could be stimulated in the oceans. As the mass of plankton grew, it would mop up CO_2; when the little plants died, they would sink to the ocean floor. The missing ingredient to trigger one of these blooms is iron, which is scarce in some otherwise mineral-rich waters around the globe. But in experiments researchers have shown that a spritz of iron can spawn algae blooms even in fairly barren waters. **Risks:** Unlike a solar shade, this approach would take a long time to lower global temperatures, and huge blooms might harm sea life by depleting waters of vital minerals.

3 CLOUD FACTORIES Some of the sun's rays are reflected back into space by clouds, ice, snow, and dust. The impact can be significant. A single, big volcanic eruption can spew enough fine matter into the air to lower the earth's surface temperatures. To replicate this effect, Stephen Salter at the University of Edinburgh ponders a fleet of floating cloud generators. Mounted on active or retired freighters and powered by wind or wave energy, the vessels would use vertical turbines to spin ocean water into a fine salty mist. Once airborne, the salt molecules would seed the formation of big bank of white, highly reflective clouds. **Risl** This approach could cause unwantec increases in rainfall in many areas. Tl size and cost of deploying a mammo cloud fleet is also unknown.

4 MOVING OCEANS If the seas rise too high, why not relocate the waters to low-lying deserts? Futurist Kim Stanley Robinson explores this idea in his upcoming novel *Sixty Days and Counting*. Engineers might construct sprawling nuclear-powered waterworks to pump the oceans into desert basins such as Death Valley or the Arabian Desert. **Risks:** In principle, this isn't different from rerouting rivers to thir cities, but the energy expenditure would be enormous. And the impact of the new bodies of water on nearby regions is hard to predict.

5 SALTING THE SEAS Scientists wo that freshwater from melting Arctic ice and Greenland's glaciers will dilute and disrupt the Gulf Stream as it loops through the North Atlantic. In the past, when this conveyor belt of warm water ha stalled, Northern Europe was sent i a mini-Ice Age. To keep the current flowing, Robinson suggests that tar loads of mineral salt could be dum into the sea at key points along the Gulf Stream. Since saltier, denser water sinks, staggered deliveries of salt could jolt the cycle and keep th current going. **Risks:** Altering ocea chemistry on this scale could have catastrophic effects on sea life. Wil we have a choice, though? "I'm as dubious about geo-engineering as anyone else," says Robinson. "But the fact is, with climate change we already doing it."

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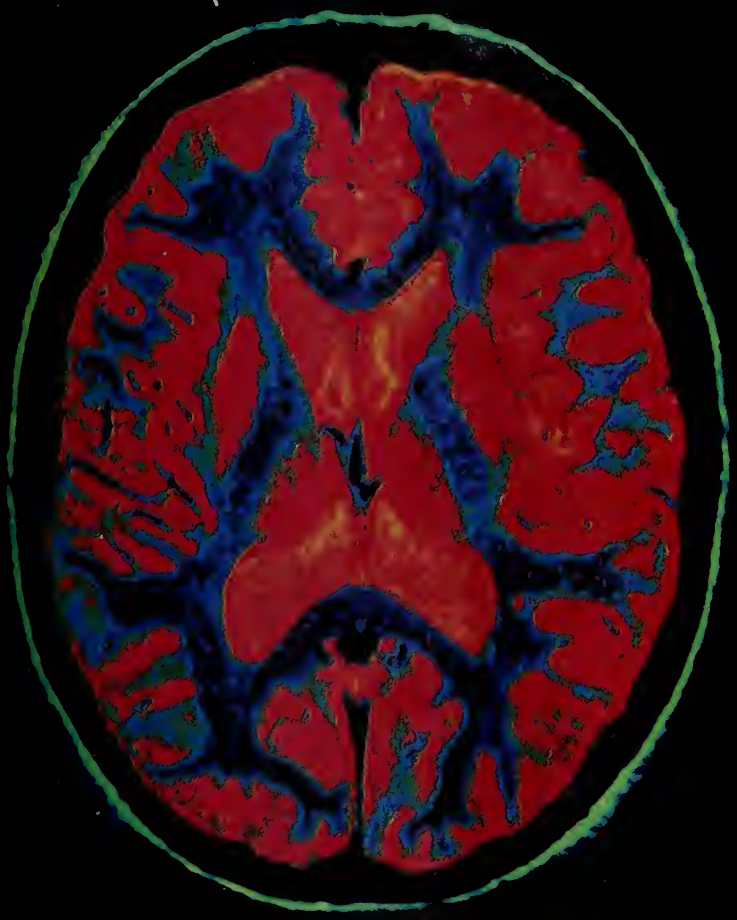

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BusinessWeek

The Top Givers

High tech's deepest pockets stole the headlines this year. It's getting tougher to join the club

By Suzanne Woolley & Bremen Leak

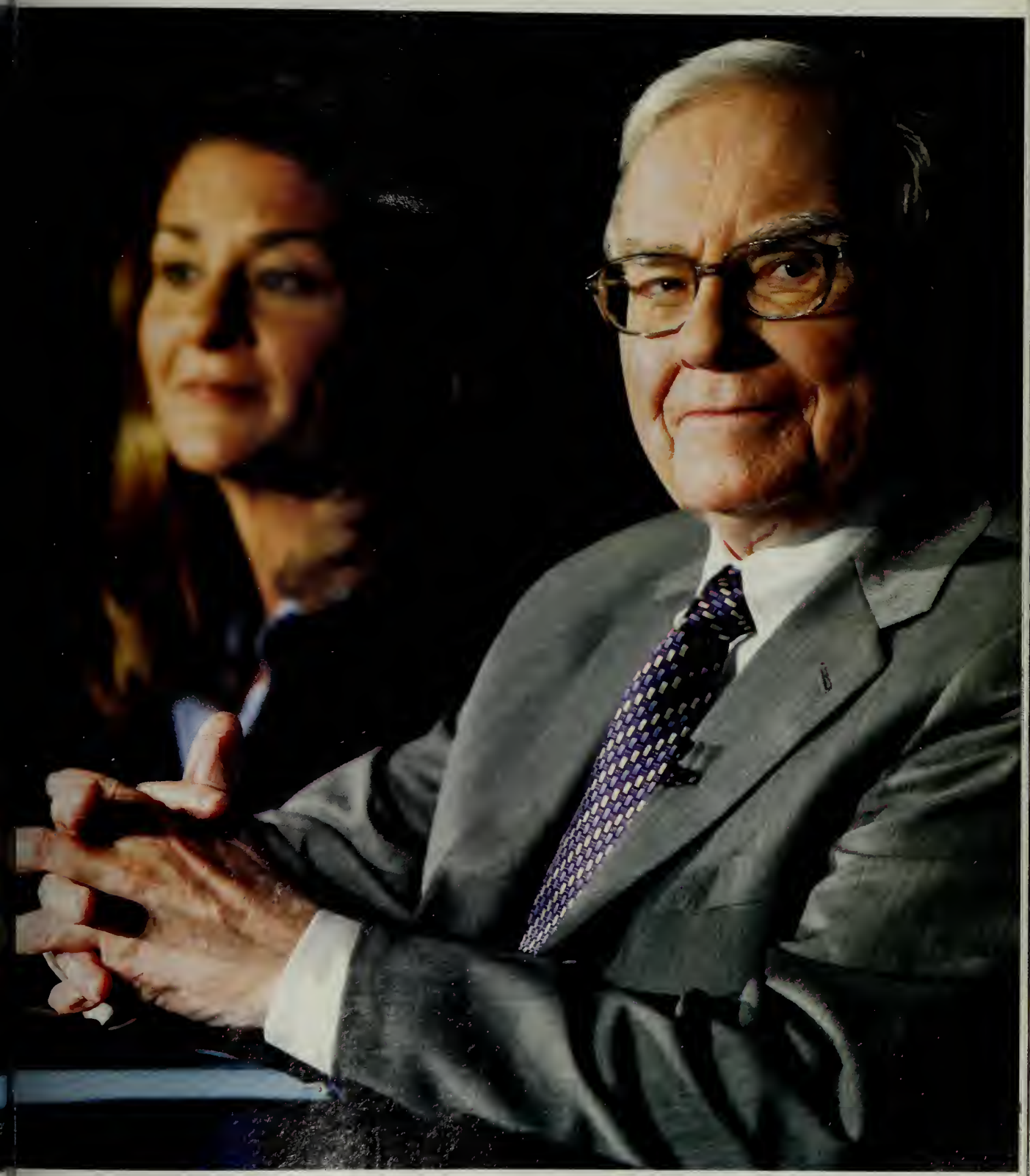
GARGANTUAN IS THE ONLY WAY TO DESCRIBE IT. The past year was one of superlatives in the giving world, capped by the announcement of a planned $31 billion transfer of wealth from the world's second-richest man, Berkshire Hathaway's Warren Buffett, to the foundation of the world's richest man, Buffett friend and Microsoft Corp. co-founder Bill Gates. The news electrified the philanthropic world, sparking talk of a new golden age of giving. The buzz continued at the year's most-talked-about philanthropic event, the Clinton Global Initiative. In three days, the organization raised 215 commitments, valued at $7.3 billion, to tackle issues such as poverty and global warming.

The big names and even bigger money are accompanied by suitably ambitious goals. To list just a few: finding vaccines for malaria and HIV/AIDs, breaking the cycle of poverty, and stopping nuclear proliferation. Tech luminaries such as Gates, eBay Inc. founder Pierre Omidyar, Dell Inc. Chairman Michael Dell, and former eBay President Jeff Skoll, among other high-profile givers, are intent on bringing about massive social change within their lifetimes. In an e-mail, former President Bill Clinton, whose initiative attracts a broad swath of public and private players, notes that "when people come together and work for change, when they collaborate in innovative ways, their collective impact can be extraordinary."

Joining Gates and Buffett at the top of *BusinessWeek*'s annual list of 50 Most Generous Philanthropists are two new names, former Golden West Financial Corp. co-CEOs Herbert and Marion Sandler, and businessman Bernard Osher, Marion's brother and an early backer of Golden West. The Sandlers built the Oakland (Calif.)-based company into the nation's second-largest savings and loan before merging it with Wachovia

» Triumvirate of titans: The Gateses and old friend Warren B announcing their philanthropic partnership

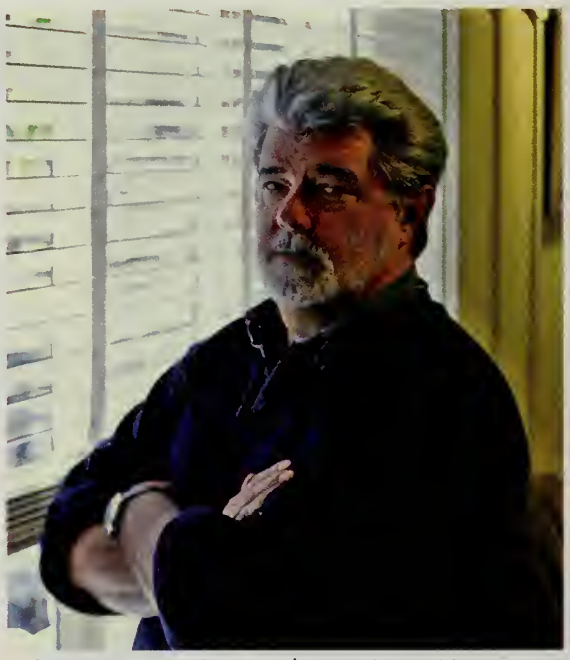
JUSTIN LANE/EPA/CORBIS



Corp. in a $24 billion deal announced in May. In June, the Sandlers reported donations of Golden West stock worth some $1.3 billion to unidentified charities; Osher's given some $723 million to charity so far this year.

Such mammoth gifts made it harder to get on *BusinessWeek's* list. The bar jumped to $157 million in giving over the past five years, up from $120 million last year. "The scale and pace [of giving] has changed," notes Sara Engelhardt, president of the Foundation Center. The universe of givers is changing, too. "The new philanthropy includes different kinds of individuals—not just the old industrialists, but people in theater and politics, business and the young—all getting on board."

Eleven new names made it on board *BusinessWeek's* ranking, with more money coming from fortunes made in the hedge fund and energy world. Giving to global causes was up, and big money went to promote research for disorders and diseases where donors have a personal connection. Renaissance Technologies Corp. hedge fund mogul James H. Simons and his wife, Marilyn Hawrys Simons, for instance, have been big supporters of research into autism; their daughter Audrey has a mild form of it. They plan to devote $100 million to investigating the disorder over t he next five years. Simons, a former chair of the mathematics department at Stony Brook University in New York, also supports math and science education.



»George Lucas is donating $175 million to his alma mater, USC, to further cinema scholarship

Dan L. Duncan, chairman of energy services company Enterprise Products Partners and a cancer survivor, donates much of his money to research the disease. Duncan, who lost three family members to cancer, gave $100 million to Houston-based Baylor College of Medicine in early 2006 to fund new cancer center.

Supporting one's alma ma fueled a lot of mega-givi Oklahoma State University, one, is benefiting from a de sion made in the late 1940s give a young T. Boone Picke a basketball scholarship af Texas A&M University cut h from the team. Pickens, w heads up $4 billion hedge fu BP Capital Management, ma a $165 million gift to Oklaho State University's athletics p gram. Says Pickens: "I'm and want OSU to be competit in the Big 12 before I'm gone

University of Southern C fornia alum and *Star Wars* c ator George Lucas also mad splash with a $175 million to USC. The money will fu a 137,000-square-foot sch for cinematic arts and supp the school's endowment. Ho wood's foremost proponent digital filmmaking hopes the money convince academia to take the cinem arts more seriously. "Film is history. H can that not be an important part of so ety?" asks Lucas.

Preserving history also motivates tired hedge fund manager Robert W. W son. He recently announced four $ million challenge grants, to the W Monuments Fund, Environmental fense, Wildlife Conservation Society, the Nature Conservancy. "I decided try and preserve things that, but for money, might go away forever," he s The groups can reach the $100 mill mark by meeting certain fund-rais goals such as raising more money f overseas. Wilson, 80, says his pla to give away 70% of his wealth (his worth tops $500 million) before he d

Wilson wants to preserve natural man-made wonders, but the characte tically straight-talking Ted Turner b conservation down to its essence. Nuclear Threat Initiative, created to c bat nuclear proliferation, wants to ens mankind is around to enjoy such thi "Humanity may not be here in 30 t years if we have a nuclear war," says CNN founder. Kind of puts things in spective, doesn't it? ■

Philanthropic Sleuthing

Tracking down and confirming philanthropic gifts can be a difficult task. Many donors have no desire to have their praises sung, or their gifts revealed, in the press. Even when a gift is announced, assigning a hard-and-fast value to it can be tricky. Gifts of stock can swing in value, and public information is often scarce.

To compile our ranking, a team of reporters pore over news reports, parse foundation filings, scour databases and conduct countless interviews. In this, our fifth annual survey, we continue to rank givers on what they have pledged or given over the past five years. Pledges are factored into our tally because we think philanthropists who make legally binding promises deserve to be recognized. For consistency, we count all pledges at the value at the time they were announced, discounting only those that have been formally revoked.

For more information on our ranking methodology, visit http://www.businessweek.com/bwdaily/philanthropy/

he 50 Most Generous Philanthropists

K NAME ORS NEW FROM LAST YEAR	BACKGROUND	2002-06 GIVEN OR PLEDGED (MILLIONS)	CAUSES	ESTIMATED LIFETIME GIVING* (MILLIONS)	NET WORTH** (MILLIONS)	GIVING AS A % OF NET WORTH
Warren Buffett	Berkshire Hathaway CEO	40,612	Health, education, humanitarian causes	40,730	46,000	89
Bill and Melinda Gates	Microsoft co-founder	3,350	Global health and development, education	27,976	53,000	53
George Soros	Investor	2,066	Open and democratic societies	5,900	8,500	69
Gordon and Betty Moore	Intel co-founder	2,049	Environment, science	7,386	3,400	217
Herbert and Marion Sandler	Golden West co-founders	1,379	Medical research, education, social reform	1,379	2,400	57
Eli and Edythe Broad	SunAmerica, KB Home founder	1,378	Public education, arts, science	2,111	5,800	36
Walton Family	Family of Wal-Mart founder	1,250	Education	1,790	82,500	2
Donald Bren	Real estate developer	935	Education, conservation	946	8,500	11
Bernard Osher	Banking, investments	805	Arts, education, integrative medicine	805	900	89
Alfred Mann	Medical devices	698	Biomedical education and research	1,735	2,200	79
Michael and Susan Dell	Dell founder	674	Children's health, education	1,230	15,500	8
George Kaiser	Oil and gas, banking, real estate	639	Poverty in Oklahoma	723	8,500	9
Ruth Lilly	Eli Lilly heiress	560	Poetry, libraries, culture, scholarships	770	200	385
David Rockefeller	Standard Oil heir, banking	550	Biomed research, global development, arts	900	2,600	35
Michael Bloomberg	Bloomberg founder, NYC mayor	550	Public health, education, arts, social services	880	5,300	17
John Templeton	Investor	511	Science "about life's big questions"	1,000	2,000	50
Veronica Atkins	Widow of Dr. Robert Atkins	500	Eradication of obesity and diabetes	500	60	833
Jeff Skoll	Founding president of eBay	486	Social entrepreneurs	613	3,500	18
Pierre and Pam Omidyar	eBay chairman and founder	453	Individual self-empowerment	577	7,700	7
Robert Wilson	Investor	449	Environment	500	500	100
Irwin and Joan Jacobs	Qualcomm co-founder	425	Education, arts	582	1,700	34
Ted Turner	CNN founder	423	Environment, global security	1,303	1,900	69
Kirk Kerkorian	Investor	419	Humanitarian and Armenian causes	696	9,000	8
Shelby White	Widow of investor Leon Levy	340	Ancient studies, arts, humanities	500	600	83
Bernard Marcus	Home Depot co-founder	317	Jewish causes, health, free enterprise, children	650	1,900	34
Robert Meyerhoff	Real estate developer	304	Arts, higher education	305	NA	NA
Paul Allen	Microsoft co-founder	287	Arts, health/human services, science	876	16,000	5
Thomas Monaghan	Domino's Pizza founder	283	Catholic higher education	454	450	101
T. Boone Pickens	Energy and investing	270	Higher education and athletics, health	300	2,700	11
Dawn Greene	Widow of lawyer Jerome Greene	260	Education, medicine, arts	260	NA	NA
James Simons	Investor	257	Math and science education, autism	257	4,000	6
Oprah Winfrey	Harpo chairman	251	Education; women, children, and families	303	1,500	20
Lewis and Dorothy Cullman	Leveraged buyouts	250	Arts, education	250	50	500
Frances Comer	Widow of Lands' End founder Gary Comer	246	Environment, education, youth	268	1,000	27
David and Cheryl Duffield	PeopleSoft co-founder	246	Animals, humane society, education	331	1,200	28
Ira and Mary Lou Fulton	Fulton Homes CEO	234	Higher education, community, cancer	265	445	60
Frank and Jane Batten	Landmark Comm. founder	228	Education, early childhood development	400	1,400	29
David Geffen	DreamWorks co-founder	211	HIV/AIDS, civil liberties, arts and culture	273	4,600	6
Larry Ellison	Oracle CEO	210	Research on aging and diseases	790	19,500	4
Peter Lewis	Progressive chairman	210	Arts, environment, youth, social reform	400	1,400	29
William and Alice Goodwin	AMF Bowling chairman	208	Cancer research, higher education	270	100	270
George Lucas	Lucasfilm founder	203	Education and arts, health, civil rights	209	3,600	6
Marguerite Hoffman	Widow of investor Robert Hoffman	197	Dallas arts and social services, science	205	NA	NA
John Kluge	Metromedia founder	196	Library of Congress, higher education	751	9,100	8
H.F. and Marguerite Lenfest	Former Suburban Cable owner	191	Higher education, arts, environment	470	825	57
Leo and Kay Drey	Schram Glass heir, silviculture	180	Conservation	180	NA	NA
Charles and Helen Schwab	Charles Schwab founder	167	Social issues, education, arts	233	4,600	5
Bernard Gordon	Analogic, NeuroLogica co-founder	160	Engineering education, medical research	165	135	122
T. Denny Sanford	Banking and credit cards	159	Children, health, science, education	159	2,500	6
Dan Duncan	Energy	157	Medical research, education, youth	160	7,500	2

d on public records and interviews with donors **Based on the Forbes 400 list and *BusinessWeek* estimates **Data:** *BusinessWeek*, GuideStar, *The Chronicle of Philanthropy*, Kintera PIN Electronic Screening

» In Uganda, Grameen Bank borrower Fatima Serwoni is her village's phone operator

Taking Tiny Loans to the Next Level

Muhammad Yunus' Nobel Peace Prize put a global spotlight on microfinance. Now the titans of technology aim to add scale, efficiency—and a lot more capital

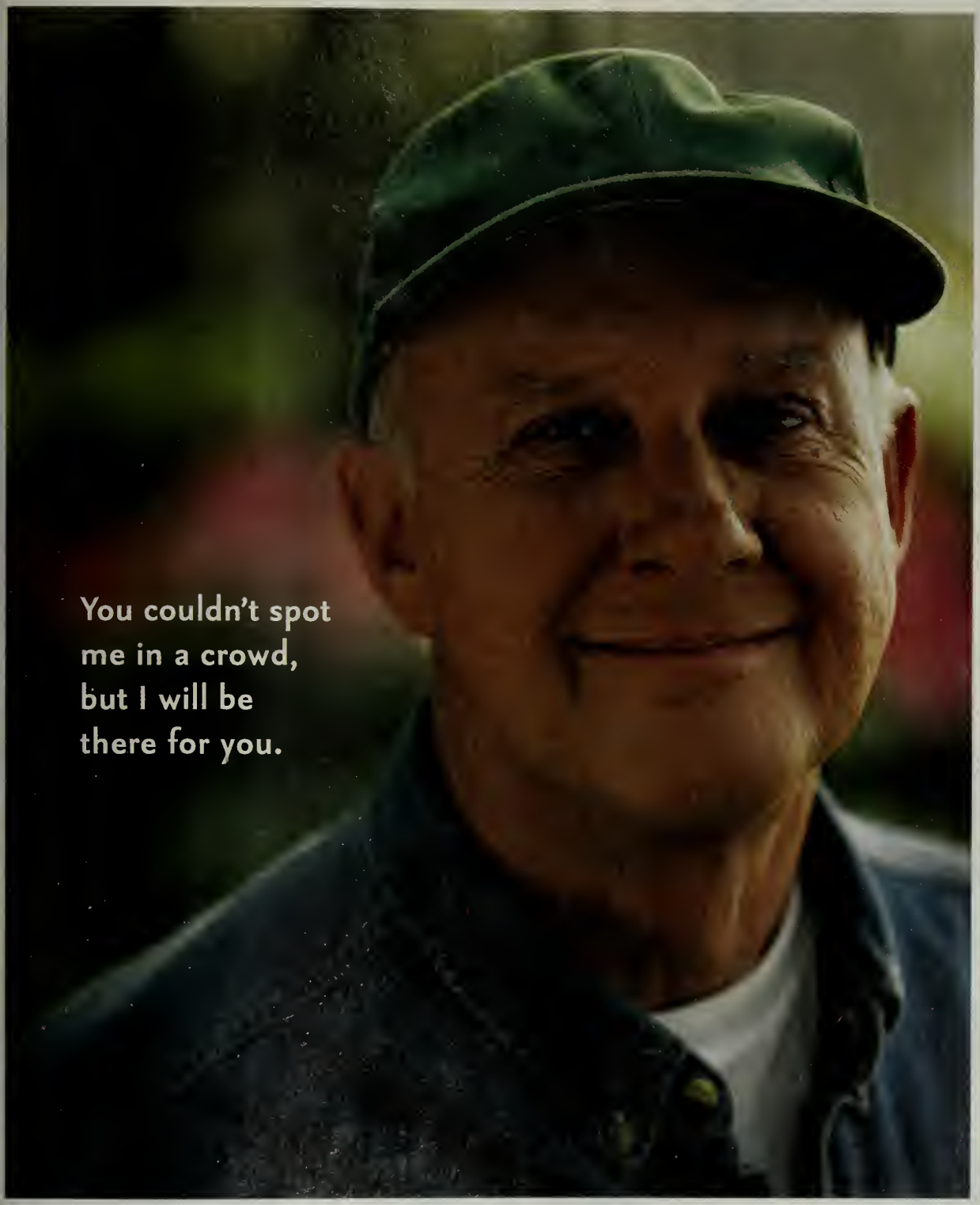
BY JAY GREENE

AN IDEA, NOT A PERSON, WAS the most powerful force in philanthropy in 2006. President Bill Clinton devoted a big chunk of his annual Clinton Global Initiative to exploring it. The mighty Bill & Melinda Gates Foundation endorsed it. The choice of the 2006 Nobel Peace Prize winner was a tribute to it. It was truly the year of microfinance.

The energy, money, and brainpower being devoted to the practice of lending to the world's poor is unprecedented. "Previously, if we screamed, people didn't listen. Now, if we whisper, the whole world will hear," says Muhammad Yunus, who shares the Nobel Peace Prize with his Bangladesh-based Grameen Bank (page 82). Yunus pioneered microfinance in the 1970s and continues to expand its boundaries. But some of the most exciting innovations reshaping the field spring from a new breed of philanthropists who hail, in large part, from the tech world.

Their approaches to tackling the immense problem of worldwide poverty range from the conventional, such as funding research, to the controversial, such as advocating a stronger focus making profits from lending to the p As befits captains of the tech indu their efforts center on bringing s efficiency, and transparency to a f mented, often inefficient area.

At the heart of microfinance is mi credit, the practice of offering small, secured loans to poor people not se by banks. The loans, often just $5 $150, are used to buy everything f buffaloes that produce milk to sel markets to mobile phones that villa can pay to use. Borrowers are usu women, in part because studies s



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7,000 **NUMBER** of microfinance institutions serving 16 million of the world's poor

that women are more likely to use their earnings to pay for family needs than men. Interest rates, which average a hefty 35%, are still far below rates charged by local moneylenders. Repayment rates are said to run from 95% to 98%, though some suspect that figure is overstated.

» Borrowers in Kolkata, India, make repayments at th weekly group meeting with their loan officer

Proponents say the beauty of microfinance is how a small amount of money can have a ripple effect on so many lives. In capitalist terms, it's the power of leverage. In human terms, it's the story of Dorothy Njobvu Kanjautso, a 35-year-old mother of three in Malawi who was widowed eight years ago. Through Opportunity International, a nonprofit group that received the Gates Foundation's first-ever microfinance grant in late 2005, she has taken out six loans over the last three years to build a school with seven teachers and start a separate business selling frozen treats from a cart. She used her first $70 loan to buy mats and games for the children; subsequent loans let her add a primary school and expand enrollment.

Being able to employ other people in the community is one way Kanjautso's loans paid off. At home the loans have improved the nutrition and education of her children. Before their mother's business took off, Kelvin, 12, Natasha, 11, and Vanessa, 9, ate meat maybe once a month, and meals were not particularly nutritious. Now they eat meat once a week and have a more balanced diet. They go to a private school with a 30-to-1 teacher-student ratio, far better than the 70-to-1 ratio in government schools. Better education and nutrition greatly increase the odds of their being able to stay above the poverty line.

Almost as important as the Nobel in putting microfinance on the map is embrace by the tech elite. Those incl Microsoft Corp.'s Gates and his $32 bil foundation, Michael and Susan Dell their $1.2 billion foundation, and the $ million Omidyar Network, created by e founder Pierre Omidyar and his wife P The Omidyars split their money betw a $270 million pool for not-for-profit tures and a $200 million pool devote for-profit investments.

The technology and microfina worlds converged at a pivotal Novem 2004, meeting at the house of John err, the preeminent Silicon Valley ven capitalist. Doerr, who has pumped clos $20 million into the sector, invited som

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113 MILLION Number of borrowers who received microfinance loans in 2005

50 to 150 DOLLARS Average size of a microcredit loan

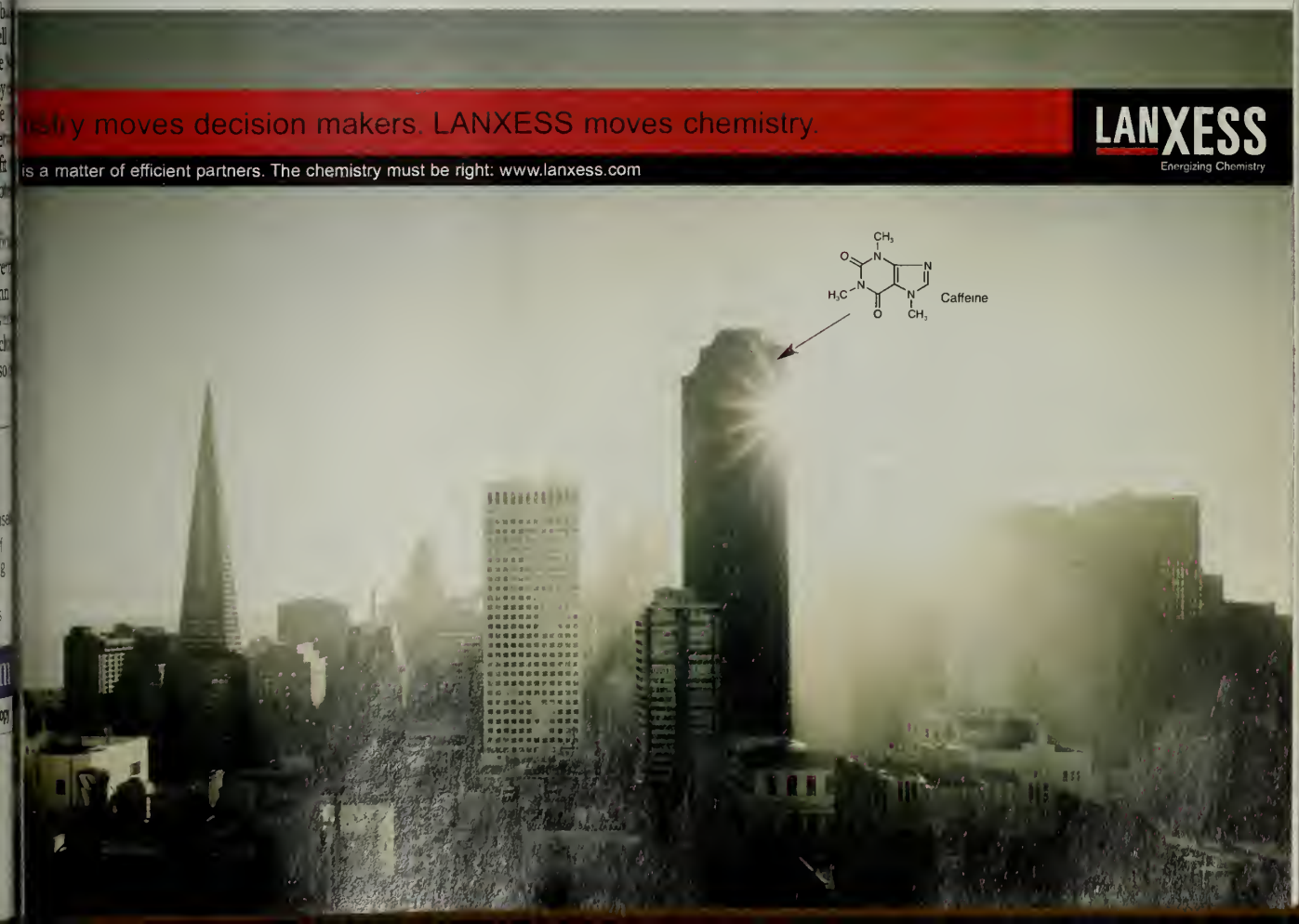
leading digerati of the day, including idyar and Google Inc. founders Larry e and Sergey Brin, to brainstorm with us, Grameen Foundation President Counts, and others. It was a "catalytic it," says Counts. "These are people saw technology change the lives of richest 1 billion people of the world in latively short period of time, and they ed a significant role in it. Now, they t to do that with the poor."

he entrepreneurs come equipped technological expertise, high-level blem-solving skills, and a finely honed se of what it takes to get a business up ritical mass. They are invigorated, put off, by complex problems. Says idyar: "This is just another large-e systems challenge."

ike tech, microfinance makes a lot more financial sense when it achieves scale. Selling a little bit of software on thin margins isn't much of a business. But sell boatloads and you just might become Bill Gates. Similarly, lenders can't maximize impact if they operate with only a few hundred or thousand borrowers. So the new forces in microfinance want to bring more scale to the industry. There's a long way to go, but the effort is making progress. The Microcredit Summit Campaign, launched in 1997 to "reach 100 million of the world's poorest families...with credit for self-employment and other financial and business services by the year 2005," didn't reach that goal, but it should hit the mark by yearend. Its new goal is to reach a total of 175 million of the world's poorest families by 2015.

The most provocative argument about how microlenders can achieve scale comes from Omidyar. He maintains that there is no way philanthropy alone can deliver loans to the world's poor. "To scale [up], to get to 500 million people, I believe, is going to come from the for-profit side, because there isn't enough nonprofit capital to get there," he says. One tack: Omidyar Network's lead investment in the for-profit Unitus Equity Fund, an $8.5 million microfinance venture investor. The fund invests in microfinance institutions in Asia and Latin America with the aim of helping them grow and become more efficient.

Microfinance operations must streamline if they want to reach the maximum number of people. To facilitate that goal, this October the Gates Foundation gave $1.5 million to Unitus, the same Red-



84 PERCENT Proportion of microcredit recipients who are women

35 PERCENT Average interest, which far below local moneylenders' ra

mond (Wash.) organization that launched the equity fund. Unitus also works to help midsize microfinance institutions in India, Latin America, and other developing regions grow into more efficient operations that can pass savings along in lower interest rates for borrowers.

Unitus used the Gates money to hire four consultants from the for-profit banking world to figure out ways to improve cost structures. Since some 70% of all microfinance institutions have fewer than 2,500 borrowers, "they're stuck small," says Unitus Chairman Mike Murray, a former Microsoft and Apple Computer Inc. exec who has committed more than $10 million of his own money to the cause.

The Gates Foundation's efforts, which range from funding a trans-African network of commercial banks for the poor to a plan to bring credit unions to the poorest regions of the developing world, also support technologies that push beyond what is common in the West. In a region where banking services are often nonexistent, it has helped fund one of the more innovative approaches. A $2.2 million grant to Opportunity International in late 2005 included funds to help hand out biometric smart cards to clients of the group's microfinance institution in Malawi. The cards work much like ATM cards except they use fingerprint-reading technology. That's important because most clients don't have official identification documents since they don't drive and don't travel outside the country. When Malawi entrepreneur Kanjautso uses the ATM, she says she feels like one of the wealthy travelers that she associates with ATMs: "I look like a foreigner. I'm so proud of it." Now, Gates and others are trying to expand the use of mobile ATMs—armored machines on the back of Jeeps—to bring money to villages on a scheduled basis.

The Dells' foundation is also expanding the definition of microfinance, moving it from the rural areas where the practice got its start into India's most impoverished cities. It works with two institutions that focus on bringing financial services to urban slums in cities including Mumbai and Bangalore.

» Opportunity International's banking operation in Malawi, Africa, uses fingerprint technology since few residents have ID documents

Toward that end, in May the Dell Foundation bought a 14% stake in Bangalore-based for-profit Ujjivan Financial Services. The year-old organization gives loans to the unemployed as well as to women who are employed, typically at local garment factories, who use the money to cover emergency family needs or to start a business. For the Dells, the Ujjivan investment is just a start; the foundation hopes to help launch 20 microfinance institutions to focus on the urban poor within five years.

Along with reaching new borrowers, microfinance will need to achieve a far greater level of standardization to tract more investment. Most lenders homegrown programs to keep tabs everything from loan repayments to t ability to lift the living standards of t borrowers. Omidyar has given a million grant for the creation of softv that helps microfinance institutions lect comparable data from borrowers Nov. 13, Seattle-ba Grameen Technol Center launched a software applica called Mifos, a prog designed to stand ize the way repaym data, as well as in mation on how clie lives improve as a sult of getting loans collected. Grameen give the software a in the hopes that it become widely used

Omidyar is also cused on collecting b data on microfinance stitutions. Over the two years he has put million into Microfin Information eXchang MIX Market, a nonp Web-based platform that collects fina data for more than 800 microfinance stitutions. The idea: Standardize fina reporting and provide benchmarks s vestors can make informed decisions a where to put their microfinance dollar

In the wake of the Nobel and the l generated by having America's tech targeting microfinance, a site like Market may be ideally positioned. It's kind of venture that can help move crofinance from being admired prim as a good idea to a practice that beco accepted as a good business. With crofinance, to use Yunus' words, "u the spotlight of the world," efforts Omidyar's and his peers may enable rise to the challenge. ■

–With Jeffrey Gangemi in New

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A Big Stage for Small Loans

Muhammad Yunus hopes to use his newfound status to get world governments behind microfinance

On Oct. 13 the world of microfinance came of age. That was the day that Bangladeshi economist Muhammad Yunus, who pioneered the practice of making tiny loans to desperately poor people, won the Nobel Peace Prize, along with Grameen Bank, which he founded. Now, Yunus wants to use the elevated pulpit the Nobel has given him to push governments to ease rules that inhibit the creation of more microfinance institutions. And he wants existing ones to learn to stand on their own, relying less on charitable donations. Yunus spoke with Seattle bureau chief Jay Greene at the Global Microcredit Summit in Halifax, Nova Scotia. An edited transcript of their conversation follows.

How should microfinance institutions change their approach in the wake of your winning the Nobel Prize?
Previously, if we screamed, people didn't listen. Now, if we whisper, the whole world will hear. Take advantage of that. Tell people what you want to do, and convince them. If you cannot convince them now, you will not convince them ever. We have to review our goals because now we can do much better, much bigger. After the 13th of October, I tell them: "You are taller. So you don't get the same size shirt anymore. You need a bigger size, extra large."

Has the Nobel opened doors for you?
The prize was announced right before I went to China. And the whole Chinese government treated me as a head of state. The foreign minister gave a reception. I have nothing to do with the foreign minister. And ministers from trade and industry gave me dinner in a very posh Beijing restaurant. So another Chinese program came out of it. There are 17 organizations in China who work with us in a microcredit program. But because of this now, the Chinese government set down how to do it nationwide.

Has the prize changed your personal life?
I cannot feel it yet because I am so busy.

You've talked about how you'd like to wean microcredit from philanthropy.
My experience is with Grameen Bank. We stopped taking any external money in 1995. Within our country, we borrowed in 1998 because we had a terrible flood. But we didn't go back to the donors. We went to the Central Bank. We issued bonds sold within the market to the banks. And we paid it back by 2002. After that, we didn't take out any loans. We cut off all donor links. We have plenty of m We are expanding at high speed.

With that experience, we say that body could have done that. But ea when donors wanted to give us m we were always swayed and took money. If donors hadn't given us money, we would have discovered ea that we have the strength.

Microfinance is popular in philanthro circles. Are you discouraging people giving to microfinance?
If it's a business, it should be runni a business. You wouldn't say Citi should take donations. Grameen shouldn't take donations either. P want to send us a check. I say: "T you. But you can write the c for another purpose, not Gra Bank. You can sponsor a sch ship for a poor person."

The Gates Foundation is movin into microfinance. What impac it have?
Well, [the money] shouldn't in a way that will discourage ple from finding a local so Otherwise, you don't discover own strength.

Having said that, it's ramping spend hundreds of millions of dollars on microfinance. Is the the capacity to handle that mo
Today, there are many cour where microfinance is at a ver stage. There, this money will to lift them up. The real prob legal. While the Gates Found can give money, they should negotiate with government make sure that all entities that give money to get a waiver th lows them to take deposits. the spirit is not of dependenc of creating independence.

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Giving Goes Green

Small companies are donating a portion of their sales to environmental groups through 1% For the Planet

BY JEFFREY GANGEMI

JEFF GOLDBERG WAS LOOKING for a way to tie his passion for the environment more closely to his work. After spending four years in San Diego's biotech industry, the avid surfer and outdoorsman found an answer: bamboo. It's the fastest-growing plant in the world, good for building, and grows naturally without requiring extra water, energy, or fertilizer. Even better, from a business perspective, the market for building with bamboo was almost nonexistent in the U.S., he says, so there was lots of opportunity. And so Cali Bamboo was born to market the plant as a sustainable resource.

» Jeff Goldberg gave almost $5,000 from his bamboo business to four environmental groups

A month after launching the company in 2004, Goldberg found another way to connect his commitment to the environment with his business. Cali became a member of 1% For the Planet (www.onepercentfortheplanet.org), a nonprofit group through which companies donate 1% of sales to pre-approved nonprofit environmental groups. In return for being able to market themselves with the group's 1% logo, companies submit tax forms to prove they've donated 1%, charitable groups confirm they've rec donations. Consumers have confic that a company is making a commitr and "it's a way for small business band together to make an impact env mentally," says Goldberg.

The organization was launched b tagonia Chief Executive Yvon Choui and a friend in 2001. Their reasonir companies are going to profit fron environment, they should give s thing back. Since the group's start, r bership has so zooming from 9 450 just in the 18 months. Men range from mi Patagonia to tiny fits, but most co nies have sales million or less.

So far men have donated than $12 mi This year the was $4 million. fact that dona are tied to sales r than profits is cr says Terry Kel the group's exec director. "Sales transparent number, and it's a signif commitment for companies."

Thus far the organization has proved over 1,000 environmental gr from the Bat Conservation Socie Austin, Tex., to the Appalachian M tain Club. Last year, in its first ye giving, Cali Bamboo donated a total most $5,000 to the San Diego chap Surfrider Foundation, San Diego C keeper, Amazon Watch, and Rainf Relief. In the past year business at has quadrupled, and so will its gi Says Goldberg: "It gives us hope tha little guy can still make a difference.

fer Elias and Julie Tucker, Founders, SmartsCo

On a wintry night last year, SmartsCo, a publisher of party games, received a frantic call. A retailer needed stock overnight for a holiday event. So Jen and Julie packed their cars and hand-delivered it. "Likewise," says Jen, "when we sorely needed better cash flow, American Express cared enough to make sure we got it."

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Now reaching a broader range workers and untapped industi analytics applications bring ne insights and huge returns.

It's a proven way to improve health outcomes: Pe with diabetes who regularly get their blood glucose els tested are more aware of their health status. Th turn, encourages them to take better care of themse But most people with diabetes don't have their glu levels tested often enough. What will enco patients to follow healthy behaviors as well as accepted best practice?

To uncover the answer, Carter Coberley, vice pres of the Center for Health Research at Healthwa Nashville, developed powerful analytic models ass by technology from SAS Institute Inc. that allowed sive data sets to be analyzed rapidly. Healthways, v provides health and care support programs to more two million health plan members nationwide, has pointed the behavioral hot buttons and develo outcomes-driven interventions to spur diabetics to with their physicians about taking the tests.

"We found multiple clinical metrics that we were ab improve in significant ways," Coberley says. So signif in fact, that the results will be highlighted soon in a stu a leading academic journal, which is why he won't r the specific details. But safe to say, as a result of these lytics, many people are healthier while using the healt system resources in more efficient and effective ways.

U.S. Army Unit Saves $423 Million With Cognos

The U.S. Army's Armament Research Development and Engineering Center (ARDEC) struggled to reconcile three versions of its financial data—one from its SAP R/3 transaction system, one from its SAP Business Warehouse and another from its non-SAP systems.

To solve the problem, ARDEC deployed Cognos 8 Business Intelligence across all three systems. This enabled the organization to integrate the data into consistent and accurate information. It also enabled ARDEC to leverage its SAP data and infrastructure.

Now, five levels of management at ARDEC rely on Cognos reports. Senior leadership receives dashboards, while operational staff consult able, printable reports that integrate both SA non-SAP data. Through Cognos, ARDEC has reporting times in half and over the past 10 saved its customers an estimated $423 millio

To read more about ARDEC's success Cognos BI, go to: http://www.cognos.com/ard

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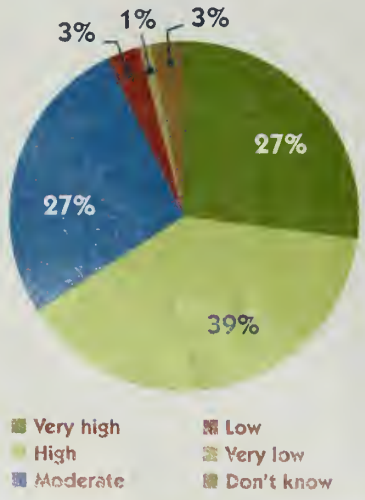
Analytics is more than just an esoteric tool to help solve medical riddles, though. Specialized versions of the software are now focused on identifying patterns and relationships in data to help customer services reps, sales agents, doctors, managers and executives more accurately predict the consequences of actions and thus make better business decisions. Once limited to power users for well-defined horizontal purposes—sales and human resources, for example—analytics now is rapidly expanding to all sorts of vertical applications as well as new users and purposes within companies.

To date, companies have scored dramatic financial benefits from their investments in predictive analytics. A recent survey by The Data Warehousing Institute (TDWI) found that almost two-thirds of companies that have implemented predictive analytics said the business value of these investments is either very high or high (see chart below).

Analytics Yields High Business Value

Percent of 166 survey respondents indicating their level of business value from analytics.



Source: The Data Warehousing Institute

"Almost all of TDWI's Leadership Award winners in the past six years have applied predictive analytics in some form or another to achieve breakthrough business results," notes Wayne Eckerson, research director of TDWI and author of the new report, "Predictive Analytics: Best Practices in Extending the Value of Your Data Warehousing Investment."

Vertical Industry Cornucopia

A wide variety of analytics tools are now available. Here is a sampler:

Industry	Types of Tools Available
Retail	Markdown analysis, store configuration, merchandise allocation, promotion optimizer
Telecommunications	Churn analysis and prevention, service plan price optimization, tracking and managing mobile phone activation process, ringtone download monitoring (to increase customer retention)
Manufacturing	Quality control, warranty analysis, service parts forecasting
Financial Services	Customer up-sell and cross-sell candidates, consumer credit worthiness, insurability, risk management (interest rates, duration, equity values)
Government	Disaster management, adherence to security regulations, fleet management
Healthcare	Clinical trial patient data analysis, outcomes analysis, preventive care strategi
Media & Publishing	Subscription analysis, circulation analysis, pricing analysis
Utilities	Billing analysis, usage analysis, facility location planning

Sources: Industry officials

It's a Process

Jason Rose, director of product marketing at Business Objects SA, notes that vertical applications are spreading to industries like financial services, retail, telecommunications and government "because they each have certain specialized processes, so they can get huge returns as BI vendors work hard to understand those processes and to better understand how these companies achieve profitability."

"With such stellar credentials, the only perplexing thing about predictive analytics is why so many organizations have yet to employ it," says TDWI's Eckerson, whose comprehensive report notes the best practices for analytics as well as the myths surrounding it. These myths include:

- Analytic modeling tools require a PhD in statistics to use.
- Predictive analytics eliminates the need to know your business.
- One type of predictive model and algorithm always works best for each type of problem.

"Analytics are being used across all
els and functional areas of the busin
and across a broad spectrum of vert
industries," says Dan Everett, resea
director at Ventana Research. Here
small sampling:

Retail. A small retailer specializing
clothing and accessories for young r
and women uses analytics to reduce
of-stocks, increase inventory turns
minimize markdowns through impro
merchandise planning. The company m
itors store-by-store sales mix trends—s
as "Punk," "Gothic," "Club" and "Street
across its target market segments, wh
are highly influenced by fashion trends
vary across geographies.

Financial. A premier financial serv
company uses analytics to provide a
lysts with real-time information to qui
assess risk resulting from changing co
tions in different market segments.
example, analysts can now better und
stand their exposure across regions
operating units if, say, a large comp
underperforms financially or the condi
of debt collateral changes.

Manufacturing. Using analytics, a p
er monitors manufacturing floor activ
across 63 plants to analyze best ope
ing practices and processes.
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Hyundai Speeds Budgeting With Business Objects

Since introducing Korea-made Hyundai vehicles to the U.S. market in 1986, independent automotive distributor Hyundai Motor America (HMA) has broadened its offerings to include eight models. Providing high-quality vehicles with "America's best warranty" at the lowest possible price led to rapid sales growth.

With its rapid growth, HMA could no longer rely on Excel spreadsheets to gather and analyze expenses from 200 cost centers, in addition to linking and consolidating up to 500 user files to create an annual budget. "To continue to manage all of those budgets, we'd need an army of temps," notes Jim Carter, national manager of financial planning and analysis at HMA.

By selecting Business Objects software for planning and budgeting, HMA accelerated its budget process and improved data integrity. Furtherm the software gave HMA the flexibility to e revise budgets as costs changed. "W BusinessObjects Budgeting we can painl change the cost whenever we need to," Carter s

To read more about Hyundai Motor Amer success using BusinessObjects Budgeting, go http://www.businessobjects.com/hyundai

using dashboards of operational metrics. Within the first six months, it lowered production costs by $5 million through improved insight into how to optimize the staffing of printing presses.

Packaged Goods. A global consumer packaged goods company uses analytics to increase overall market share against competitors by modeling product cannibalization rates after line extensions are introduced. The company models scenarios with many different input variables to see the effect over time of new products or product groups it and competitors introduce. The product cannibalization modeling is critical to the company because some products can swing market share by 10 to 20 percentage points, representing hundreds of millions of dollars in revenue.

"These kinds of tools allow companies to get in touch with the attitudes of their end customers in a way they never could before," says Rob Rose, chief strategy officer at Cognos Inc. "This power increases exponentially as analytics are applied to specific industry issues, such as pharmaceutical companies analyzing the most effective use of free samples to the medical community."

Larry E. Rosenberger, vice president for EDM applications and R&D at Fair Isaac Corp., notes that what's going on now is an evolution in the three stages of analytics: First, exploratory (or data mining), where insights are gleaned from customer data; second, predictive analytics, where marketing information could be sent to customers based on their anticipated behavior (such as the likelihood to repay loans); and third, decision analysis, which studies a variety of relevant data and predictions to make decisions on things such as how to time promotions and determine the most effective promotional mix. "This is the next big thing in analytics—it's what the first movers are exploring right now," he says.

"Many vertical industries are realizing that the data they collected for other purposes can be put to new uses, making better decisions," Rosenberger adds. "The recognition that companies can differentiate themselves through their use of analytics is being spurred by advances in computing power, data power and data storage."

Huge Payoff

The tremendous payoff from analytics efforts is affirmed by a new survey from Accenture of 700 executives and CIOs at 371 companies. Successful companies are five times more likely to cite analytics as a key element of their business strategy, the study found. In a 2002 survey, Accenture found that 55 percent of respondents had some analytical capabilities and 19 percent had significant analytical capabilities. Those numbers have jumped to 74 percent and 33 percent, respectively, in the current survey. What's more, the top three types of software that companies plan to introduce in the next few years are analytical-intensive applications, including customer relationship management products, data warehouse solutions and supplier relationship management systems.

Joshua Greenbaum, principal ana at Enterprise Applications Consult calls vertical analytics tools "the futu of business intelligence. He conte what companies really need is BI tha very proactive and very deeply vert ized, BI that understands the spe requirements of a particular user i particular industry.

continued on pag

Vertical Analytics Resource

To see an electronic version of this section rea for e-mailing to colleagues, please go to http://www.businessweek.com/adsections and click on the headline "Analyze This...And This...And That, Too." A collection of related research reports, case studies and other mate are available at the online BusinessWeek Busin Intelligence Knowledge Center. Please visit: http://knowledgecenter.businessweek.com/bb intelligence/index.html

In addition, the Web site has hot links to the following organizations' case studies, researc reports and other valuable information:

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Cognos Inc.
http://www.cognos.com

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Today's best businesses compete on advanced analytics. Across the enterprise, lines of business are starving for fast, accurate information to make the vital decisions needed to grow their business. But the limitations of the underlying data warehouse infrastructure powering these important BI initiatives can hinder progress. Enter the Netezza data warehouse appliance, a disruptive technology that has re-energized the data warehouse industry and makes competing on advanced analytics a reality.

President and COO, Jim Baum

As the global data warehouse appliance leader, Netezza architecturally integrates database, server and storage in a system designed specifically to handle the depth and breadth of analyses companies now need to compete. With the simplicity and low total cost of ownership of the Netezza Performance Server® system, companies can extend the benefits of BI further across the enterprise. Global brand-name companies, including Ahold, Amazon.com, Catalina Marketing, Orange UK and Ryder System Inc., leverage Netezza's system for fast and sophisticated predictive analytics that provide a significant competitive advantage. Netezza data warehouse appliances enable organizations to not only better understand today's business but also find tomorrow's hidden opportunities.

NETEZZA

The Power to Question Everything

Don't Forget the Horsepower

As with any amazing new technology, there's always a gotcha. BI and analytics systems, with their ability to add value widely throughout an organization, promise huge benefits, namely improved decision-making. The catch? Such popularity creates performance issues.

After almost a decade since their introduction, business intelligence and analytics systems have grown exponentially in size, user base and number and types of queries, among other factors. Too many users asking too many tough questions about too much data can push these systems to the point of near collapse. Fortunately, there are technology solutions for the technology problem.

Improving the performance of a BI or analytics system so that it quickly provides the right information to the right people can require substantial expenditures for new servers and storage devices. In addition, solving the problem requires a team of experts to continually fine-tune the systems, repeatedly re-optimizing them as query demands evolve.

There is another approach, though. Several years ago, the plight of the overwhelmed BI/analytics infrastructure attracted a swarm of technologists with a better idea. They developed the concept of the BI appliance. Just as an Xbox or a PlayStation provides a better videogame experience than a general-purpose PC, the BI appliance is a special-purpose combination of processor, storage and software that outperforms a general-purpose server and standard BI or analytics software.

Accommodating More Data and More Users

With a BI appliance, an organization avoids the latency problem—when users submit a query, they don't have to wait days for the answer. In addition to the performance boost, the BI appliance can scale to accommodate the ever-growing amount of data to be processed and users to be satiated. Furthermore, the BI appliance doesn't have to be reconfigured every time a market shift demands new types of query processing.

There's also a direct financial benefit with a BI appliance solution compared to the traditional performance panacea of throwing more servers, storage devices and people at the problem. A BI appliance is a fully configured and integrated server, storage and software combination. As such, an organization's IT department can avoid some of the integration hassles it would face if it just tried to solve the performance problem with the traditional approach of adding more servers to the data center.

"When we show executives of large corporations how our data warehouse appliance delivers a 10- to 100-fold improvement in performance over their current system, their jaws drop," notes Jim Baum, president and chief operating officer at data warehouse appliance market pioneer Netezza Corp. "But it's the system's simplicity and low total cost of ownership, combined with its incredible performance, that really enables businesses to fully leverage their BI and make it available across the enterprise." ■

nued from page S5

deed, many of the largest BI vendors quickly rolling out new vertical tools or nering with smaller companies to pro- them—like a Price Plan Optimization that helps the telecommunications stry pinpoint how much customers willing to pay for different kinds of ser- plans. However, most experts say the ce of prebuilt vertical BI software, a eral-purpose platform or a cus- zed application will vary for each according to needs and the availabil- tools.

hn Donahue, a partner at New York- d media investment management ration GroupM Worldwide uses tics to track the performance of ts' communications campaigns and se them on how to get the biggest from their media spending. He s on technology from Business ects for his end-to-end analytics ion, such as tools that quickly com- huge amounts of data from rent sources so analysts can make adjustments to media plans.

e are not a technology company, we don't want to use our time and rces pulling the data together," ahue notes. "However, we would r outsource the analytics themselves, use that is the way our agencies dif- tiate themselves."

kaged Applications

Milley, director of technology prod- marketing at SAS, contends packaged ications will emerge primarily in ing make low-risk decisions in tactical operational areas." In contrast, she something like reducing telecom n "is so strategic to the business that t a competitive advantage, compa- need their people to wallow in the and tease out the predictive power the data models.

nalytics is very dynamic and requires ent adjustments," Milley says. ytics is about shades of gray—the cations require different levels of istication, and the information is con- d at different levels of sophistication." e and others predict the analytics market will splinter into some vertical packaged tools combined with increased customization, backed with BI advancements and better data strategies that permit information to be put into standard formats, integrated, stored and made easily accessible.

"Companies can run into a problem when they evaluate the features of a given application early," says Cognos' Rose, "but they don't think about their technical architecture and how the new tool will link into other applications until well after the fact."

That is changing as new types of people become involved in using and evaluating analytics tools for their companies and industries. "As analytics becomes more vertical, chief financial officers and financial managers are becoming more involved in the decision making," says Rose of Business Objects. "And what they're concerned about is the usability and accessibility of the interface, so information can be accessed graphically, with easy-to-use menus and the appropriate business and industry language."

Just ask GroupM's Donahue, whose analysts use new tools to allow them to do analytics using familiar Excel spreadsheets: "At most media agencies, there are huge farms of Excel jockeys. So a tool that allows model visualization and model development in some part through Excel is a huge advantage for us." ■

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Season's Readings

From humor to history, there's a gift book this year for almost everyone on your list.

BY THANE PETERSON

FOR CHUCKLES THIS HOLIDAY SEASON, sit down with the family and leaf through a new book called *Monkey Portraits* (Bulfinch Press, $24.99). Los Angeles photographer Jill Greenberg had the inspired idea of shooting character studies of monkeys as if they were human, and it's great fun to find the resemblances to friends and family members in these primates' expressive faces. Business associates may come to mind, too. "I've sat in studio meetings with guys like that," Sharon Stone told Greenberg when she saw a portrait labeled "Haughty."

Monkey Portraits is just one of many amusing, moving, and informative gift books out this season. Have a baseball fan on your list? *Sports Illustrated: The Baseball Book* (Sports Illustrated Books, $29.95 is packed with wonderful photos and artfully written essays on greats such as Hank Aaron, Ted Williams, and Negro Leagues' Cool Papa Bell. It also explores just about every aspect of the game, from baseball movies to the evolution of uniforms, bats, and balls.

For art lovers, Yale University Press offers two gorgeous monographs of shows at New York's Metropolitan Museum of Art. *Louis Comfort Tiffany and Laurelton Hall: An Artist's Country Estate* ($65) showcases the leaded glass creations and his collections of Asian, Islamic, and Native American art once housed on Tiffany's 600-acre Long Island retreat. *Cézanne to Picasso: Ambroise Vollard, Patron of the Avant-Garde* ($65) tells how Vollard, a Paris art dealer, helped create the modern art market by promoting many great late 19th and early 20th century artists. The book features reproductions of paintings by Cézanne, Picasso, and others.

Another book with a business angle and broad appeal is *Advertising is Dead: Long Live Advertising!* (Thames & Hudson, $60). Author Tom Himpe uses arresting images and easily digestible blurbs to explain how marketers insinuate their messages into every corner

NICHOLAS EVELEIGH

of modern life. How far will they go? Qantas Airways once put red and white ads in the center of manhole covers with the slogan "The Smarter Way Down Under." Still humorous, though decidedly less corporate, is *Cartoon America: Comic Art in the Library of Congress* (Abrams, $50), which documents the lighter side of the American psyche. The older material, such as the biting social commentary of 19th century caricaturist Thomas Nash, still resonates.

In Vogue: The Illustrated History of the World's Most Famous Fashion Magazine (Rizzoli, $75) chronicles the magazine's 114-year history and provides a visual history of American style. The book features startling images by such photographers as Irving Penn, Helmut Newton, and Annie Leibovitz. Speaking of Leibovitz, *A Photographer's Life 1990-2005* (Random House, $75) mixes her famous celebrity portraits with intimate black-and-white shots of her family life, including the birth of her children and the deaths of her father and her companion, the writer Susan Sontag.

Joel Meyerowitz's 400 color photos in *Aftermath: World Trade Center Archive* (Phaidon, $75) document the post-September 11 rescue mission and cleanup over nine months, and the chatty, unpretentious commentary lends intimacy to his account. A critically acclaimed reference book is *The Photobook: A History Vol. 2* (Phaidon, $75) by British photographer Martin Parr and critic Gerry Badger. It takes up where 2004's *Vol. 1* left off, providing thumbnail introductions to numerous photographers via incisive essays on the books they have published.

Derek Hayes's *Historical Atlas of the United States* (University of California Press, $39.95) is for history buffs. The maps show everything from how explorers conceived of the continent circa 1500 to the spread of the interstate highway system in the 1950s.

Finally, we musn't forget something for golfers. *Golf's Best New Destinations* (Abrams, $50) is a practical guide for the globe-trotting golfer, offering the lowdown on the best new courses around the world. For each locale, there are tips on where to stay and dine. As every golfer knows, being rested and well fed doesn't guarantee a low score, but it can soften the blow if you make a monkey of yourself on the course.

BusinessWeek weekend For more on gift books, watch *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com.

Jim Karas

The trainer's half-hour routine can be done right in your hotel room.

BY ADRIENNE CARTER

THINK OF YOUR LIFE when you're constantly on the road for business. You spend inordinate amounts of time sitting—in airports, conference rooms, and at dinners laden with booze and high-calorie foods. It's not the healthiest of lifestyles, to say the least.

Then again, you don't have to be a slug because you're away from home, says personal trainer Jim Karas, a former options trader and portfolio manager who gave up business for barbells 20 years ago. Drawing from his own travel experiences, he has created a quick and efficient "Expresso" workout for road warriors that can be done in a hotel gym or even in your room. "I understand what it is to be pressed for time," says Karas, 45, who has been exercise guru to the likes of TV news anchor Diane Sawyer, hotelier Penny Pritzker, and actor Hugh Jackma

Guests of the James hotel in C go's downtown River North neigh hood—where Karas demonstrated workout for *BusinessWeek*—can hire or his associates for pr lessons. But you don't Karas at your side to d routine. The only equip required: an 18- to 26 stability ball you can borrow from the hotel and two resistance b you can pack. The b should be something lik Spri Xering that reser a giant rubber band an Spri Xertube with ha on each end and speci tachments for a door.

The "Expresso" wo starts with a four-m warm-up and moves eight strengthening cises that work the u body, lower body, and muscles (table). Says K "A half-hour is all you to get the job done." ■

Perform 8-10 repetitions of each exercise for two to three minutes each.

1. Start in a squat position with Xering band encircling both ankles, shoulder-length apart. Then move your feet, one at time, forward and outward, like a speed skater. Remaining in the same squat position with the band still around your ankles, run quickly in place. (4 minutes.)

2. Squat and stand while extending hands over head with stability ball. For added difficulty, bring your hands and stability ball down when standing.

3. With ball extended out from chest, step forward with right leg, simultaneously twisting the ball to the left. Alternate with the left leg.

4. Position yourself in the plank position, face down with your back flat and forearms and elbows propped on the ball to increase intensity. Hold position for 2-3 minutes.

5. Secure the Xertube to a door above the knob using the tube's attachment device. Then, sitting on the ball, backing away from the door enough to get some resistance, grasp the Xertube fully and extend your arms straight back.

6. Place tube under feet and pull up on handles, squeezing your biceps.

7. With tubing attached to the top of the door, grasp handles at waist and press down to your side.

8. Stand on your right leg with Xering band around both ankles. Then lift your left leg slightly off the floor and press it straight back. Repeat set with right leg.

9. Sitting on the ball with tubing attached just above the doorknob, grasp both handles in left hand, folding right hand over. Extend arms, twist away from the door, and hold.

10. Stretch back, legs, and arms to cool down. (4 minutes.)

BusinessWeek.com For a show on Jim Karas' "Expres workout, go to businessweek.com/extras.

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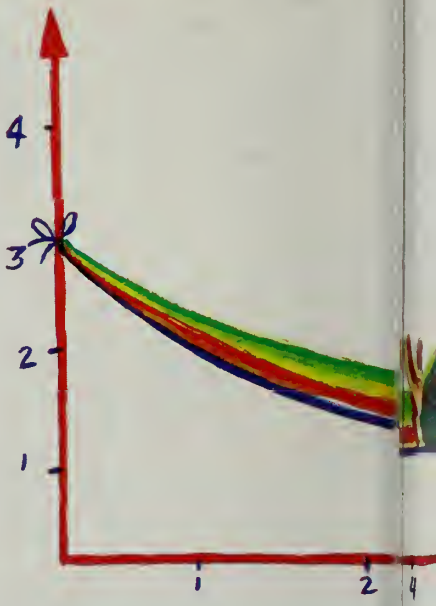
Napping Your Way to The Top

The performance boost of a midday snooze has companies signing on

Mednick

SLEEPING ON THE JOB used to be grounds for dismissal. But now, years after Cornell University psychologist James Maas coined the term "power nap," companies are beginning to embrace the practice. Today, Nike and Deloitte Consulting are among those that encourage employees to add a midday snooze to their to-do lists. Sleep scientist Sara Mednick applauds this trend. Mednick, a researcher at the Salk Institute for Biological Studies in San Diego and author of the new book *Take a Nap! Change Your Life* (Workman Publishing), says napping can enhance productivity. She explains how to Associate Editor Arlene Weintraub.



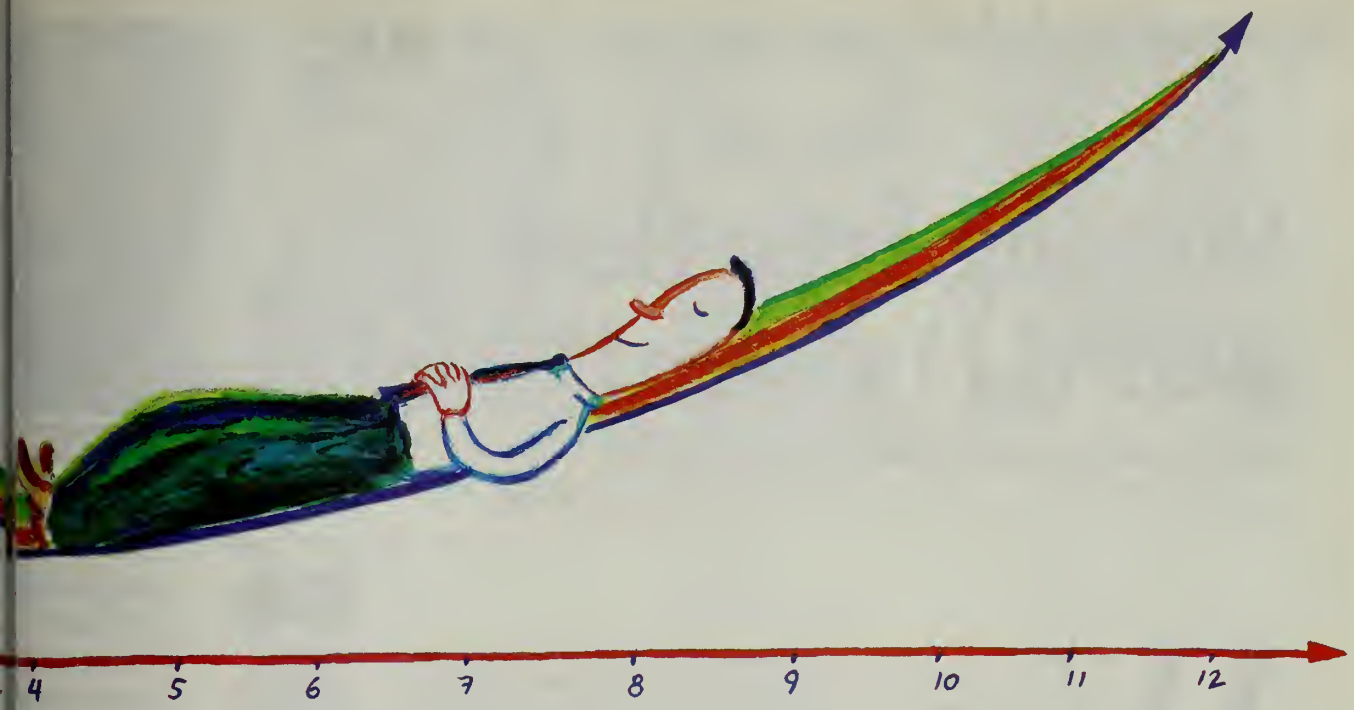
What are the main benefits of napping?
Research on sleep deprivation shows that even at six hours a night, there are all sorts of changes in the body. Insulin rises to pre-diabetes levels. There's an increase in heart disease. Without sleep you don't learn. My research shows that people deteriorate during the day. It's difficult to sustain productivity. Naps can add b to the sleep you're deprived of at ni And a nap enhances productivity eve you have enough nocturnal sleep.

You describe an "optimized napping formula" in your book. What is that?
A nap involves different stages of s that lead to different kinds of impr ments. Rapid eye movement [R sleep, for example, is good for impro creativity and perceptual ability. S wave [deep] sleep is good for resto muscle function. The formula helps harness those.

So what would be the optimum nap for a middle-aged executive working long hours?
A 20-minute nap in the afternoon, tween 1 p.m. and 3 p.m., right after lu would be ideal. You don't want to get deep sleep, because you need to be a This nap will allow you to be as pro tive right after the nap as you were fore. That's what a lot of businesspe need for on-your-feet thinking.

If your office isn't set up for napping, how can you nap?
Find a room where no one can dis you. Turn off your e-mail and pho nap on the floor of my office, with a and a blanket. I'll also nap in the ca have a meeting, I'll get there 15 min early and set my cell phone alar wake me up.

What will it take for napping to becon an accepted practice in the workplac
It has to come from CEOs reco ing that this doesn't take away



ctivity. It's not an embarrassment. pare it to telecommuting. When egan, it had a bad name. Working ne was for people who were lazy. CEOs realized they were getting from employees who were allowed k at home. I predict the same will n for napping.

do you say to people who have e napping during the day?

hem to get rid of nap blockers: too caffeine or alcohol. There's nothrong with that morning coffee at or 8 a.m. if you're going to nap at ck. But while alcohol makes you it disrupts the sleep cycle. So no i lunches. And you need to remove ental blocks—thinking you're not productive or that you're being you nap.

people are afraid to nap because feel groggy when they wake up. an they avoid that?

called "sleep inertia"—the inabilshrug off sleep. It increases as you eper and deeper into sleep. So the s to avoid getting into deep sleep. nap about 20 minutes, you'll be t sleep, which is easy to get out you can sleep longer, say about utes, to get out of deep sleep and EM.

sleep experts say people who have e sleeping at night should not nap. sagree. Why?

e most part, the research has found pping does not interfere with noc- sleep unless you have severe in- a. A 15-minute nap at 1 p.m. won't prevent you from sleeping at 10 p.m.

You describe a tactic called "extreme napping." Explain.

In some situations, where there's a lot of stress, some people can't fit in core nighttime sleep. Extreme napping is a way to regulate short amounts of sleeping and waking. So you could, over 24 hours, take a 1½-hour nap every 8 hours. It can be successful, but if you don't do it right, you could get sick. I recommend it for short-term use only—say, if you're under a deadline or you're attending a conference. Ultrashort sleep is a way to make sure your body gets enough.

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Putting Your Best Beard Forward

Tonsorial tips from a celebrity stylist on the latest fad in men's fashion. **BY STEVE HAMM**

RICHARD PAR

CEO, Time Wa

It's too botto heavy. It ma his whole face drop, a diminishes his eyes.

Hairstylist April Barton sizes up some high-profile business beards

WHEN I FIRST met hair stylist April Barton at a party in the famously bohemian Chelsea Hotel in New York, she mercifully suggested a new beard style. Before: Lincoln-esque. After: a trimmer look that rounded out my longish face. Little did I know Barton is considered, within beautiful-people circles, to be a diva of men's grooming. Who wouldn't take advice from a stylist whose client list ranges from Elvis Costello and Bono to Jake Gyllenhaal, Adrien Brody, Matthew Modine, and Jerry Seinfeld.

While facial fuzz is the rage in Hollywood and the hipper environs of Manhattan, most business executives and corporate climbers are strangers to electric beard clippers, sideburn trimmers, and other such mowing tools. Bu why shouldn't the suits loosen u give handlebar moustaches, goatee soul patches a try? The early 21st ce welcomes self-expression and cele those who dare to be different.

I found out about Barton's rep celebrity stylist only when I visite recently to learn the secrets of su ful facial hair care. Her Suite 303 occupies an airy nook overlooking tling 23rd Street. Barton, a high-e 39-year-old dressed in a denim j miniskirt, and knee-length black le boots, bears no resemblance to the ly Italian gentlemen who usually sn hair in the suburban village of Pe N.Y. She grew up in a Florida n home park, got her start styling for the high school cheerleading s and at 15 promised "to cut my wa of here." After gigs at salons in Fl England, and New York, she o Suite 303 some 10 years ago.

MAKE A STATEMENT

BARTON'S APPROACH to facial boils down to this: Don't think o face separately from the rest of yo cial hair should be a natural exte of your overall look, taking into ac head shape, hair quality and styl body type. It shouldn't be culti simply to disguise a weak chin or by cheeks (although it can certai that). Barton doesn't typically ur ents to grow beards, but she wel the decision. "It's the one thing a

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Start
Send an e-mail to your office, or maybe send one to the editor.

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ething.

STEVE WOZNIAK
Co-founder, Apple Computer

It works. He has big features so he can pull off a full beard. Most people can't.

LARRY ELLISON
CEO, Oracle

I like the mustache and chin, but the beard is too peel-and-stick.

EDGAR BRONFMAN, JR.
CEO, Warner Music

He's hot. He looks good. The only drawback is the abrupt departure under the nose.

lo that a woman can't to alter his and make a statement," she says. cial hair is a highly individual mat- o Barton is reluctant to lay down -and-fast aesthetic rules. But full ls usually don't work, she says. take attention away from the rest e face. When trimming the beard moustache, men should avoid ght lines. They create an unbecom- eel-and-stick effect. Also, when g sideburns, one should find the al break where the cheek meets the nd trim them off there.

RECTIVE ACTION

VISIT TO THE SALON, I discovered run afoul of another of her prin- s, having trimmed my beard sharply jawline. This was a no-no, it turns Barton had meant for me to gradu- eather the beard in from under the r a softer effect. So she sat me down e spot and took corrective action. e she was at it, she fixed my unruly of hair, too.

rton almost goes into a trance when styling. She furrows her brow and rs at her subject with the intensity a bird of prey. She sculpts with scis- rs and clippers, chipping, flicking, nd stabbing away in a controlled frenzy. When she was done with me, she stood back, spread her arms, and pronounced: "Movie star!" For a brief moment, I felt like one.

Barton hasn't styled for high-profile businesspeople, but she relishes the idea. When I asked who she'd like to take on, her instant answer was Donald Trump. She didn't have anything particular in mind. "I'd go buck-wild on him. His hair would tell me what to do," she says. "Donald, if you're reading this, I will change your world."

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BY ROBERT PARKER

Zinfandels Fit for a Thanksgiving Feast

ZINFANDEL IS THE ALL-AMERICAN WINE, since just about all the commercial production of the grape takes place in California. These deep, dark reds work beautifully with that all-American meal, the Thanksgiving turkey dinner. A few weeks ago we visited one of the top producers of zin, Turley Wine Cellars (BW—Oct. 30). Here are some other terrific zinfandels worth serving your family and friends on that special day. They're all from the tasty 2004 vintage.

Ridge Vineyards Buchignani Ranch
91 points. A blend of 82% zinfandel and 18% carignane, this full-bodied, inky ruby/purple-tinged cuvée reveals abundant quantities of raspberry, blueberry, black cherry, and loamy soil notes as well as a subtle hint of oak in the background. Nicely layered with good acidity, an opulent, powerful finish, and a relatively low 14.4% alcohol content, it can be enjoyed now and over the next four to six years. $24

Elyse Winery Korte Ranch Vineyard
94 points. This outrageously superb, dark ruby/purple-hued blend of 93% zinfandel and 7% petite sirah boasts crème de cassis, blackberry, raspberry, and sappy cherry-like characteristics. Full-bodied, dense, and concentrated, it is remarkably well-balanced for its potency and flavor depth. It should be enjoyable for many years. $30

Hartford Court Russian River
93 points. A blend from seven different vineyards (the average age of which is 80+ years), this gorgeously rich effort reveals a pinot noir-like sensitivity along with a seductive, fragrant nose of black raspberries, cherries, spice box, pepper, and earth. In the mouth, it's a flamboyant, expansive, full-bodied, savory wine with beautifully integrated acidity, wood, alcohol, and tannin. Drink this decadent zin over the next five to six years. $30

Robert Biale Black Chicken
93 points. With 16.5% alcohol, this Black Chicken (a Prohibition-era term for bootleg wine) sure can party. The wine has a blockbuster perfume of briery fruit, spice box, pepper, sweet currants and cherries, and licorice. Spicy, with fabulous fruit, a full-bodied opulence, loads of glycerin, and a heady finish, it can be drunk now and over next five to seven years. $34

Carlisle Tom Feeney Ranch
95 points. A deep ruby/purple color is followed by a glorious perfume of creosote, garrigue, ground pepper, bla raspberries, and cherry liqueur. Thi deep, full-bodied, concentrated, unctuously textured, rich zinfand should drink well for seven to eigh years. $38

Linne Calodo Problem Child
92 points. A 320-case blend of 72% zinfandel, 17% mourvèdre, and 11% syrah, this wine exhibits gorgeous notes of sweet and spicy black pepper, blueberries, blackberries, and raspberries, a wonderful texture, and hin of graphite, minerals, and white flowers. It classic, full-bodied, powerful (16.2% alcoh zin capable of lasting 6 to 10 years or more but who will be able to wait that long? $42

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boar tens of thousands of tasting notes, or to order his recent book, *The World's Great Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311 Monkton, MD 21111.

Wines rated from 96–100 are extraordinary; 90–95, excellent, 80–89, above average to very good. For more Parker picks, go to businessweek.com/ex

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What the Patient Pays

To find that out ahead of a medical procedure takes a good deal of digging

BY LAUREN YOUNG

FEW THINGS ARE MORE infuriating than trying to figure out how much your health plan will pay for a medical procedure. Oh yes, the glossy brochure from your benefits department seems straightforward: You pay, say, 10% of the costs if you stay in the network or 30% to 40% if you go out of network.

What your benefits handbook doesn't tell you is that prices vary even among in-network providers and that if you leave the network, you may have to pay more than 50% if your doctors charge beyond the mysterious amount the insurer deems "reasonable and customary." As more of us are pushed into plans with high deductibles, we need detailed cost data more than ever. What's a consumer supposed to do?

KNOW THE CODES

BEFORE YOU SCHEDULE any treatment, ask your doctor or hospital to provide the Current Procedural Terminology, or CPT, code expected to be used for your medical services. "The key is in the codes," says Matthew Holt, a health-care consultant in San Francisco. Because he works in the medical industry, Holt knew he wouldn't have much luck finding out how much his former insurer would pay to cover knee surgery until his physician's office provided the five CPT codes the doctor expected to submit.

Yet even with the right codes, Holt found that his insurer wouldn't tell him the actual reimbursement. "I had to play 20 questions," he says. "I asked: 'If a bill I submitted was $2,000, would insurance coverage be above or below that?'" After some back and forth, he managed to narrow the spread to a couple hundred of dollars per procedure.

Why won't insurers just provide their rate schedule? Most consider the rates they negotiate with doctors and hospitals to be proprietary, says Barry Barnett, a principal at consultant Pricewaterhouse("[They] don't want to share this i tion for competitive reasons," he s

GO ONLINE

WHILE PENDING FEDERAL leg may require more cost transpa the future, some insurers are sl

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light on costs now. Aetna and Cigna, for example, are putting cost and quality-of-care databases online in an effort to steer consumers to medical providers who deliver the best service. "The first variable is always going to be quality. People want to get out alive. They don't necessarily want to get out cheap," says Joseph Mondy, a Cigna spokesman.

Cigna's online tool (mycigna.com) allows members to search by medical providers with the best patient outcomes and cost efficiency. You can get cost data, sorted by Zip Code, on 43 of the most common kinds of medical visits and procedures. At aetnanavigator.com, participants can search among 70,000 physicians in 11 states and the District of Columbia to find the in-network rates for common treatments. The cost information provided by Aetna and Cigna is pegged to a member's specific insurance plan, telling you what you can expect to pay out of pocket.

If you aren't an Aetna or Cigna customer, try to find someone who is and can look at the data on your behalf. The results probably won't jibe with your own plan, but they should help set a benchmark. In addition, make sure you check out your insurer's Web site. Companies such as UnitedHealthcare and WellPoint provide broad cost estimates based on regional data.

A Profusion of Prices

New medical insurance plans require consum[illegible] be vigilant about costs, but information is sc[illegible] and variability is great

PROCEDURE	CITY	OUT-OF-PO[illegible] COST ESTIMATE**
COLONOSCOPY (Day surgery facility)	Palm Beach	$450 to 750
	Pittsburgh	360 to 600
	Santa Monica	510 to 560
KNEE REPLACEMENT (Hospital)*	Palm Beach	$1,516 to 2,14[illegible]
	Pittsburgh	1,202 to 2,98[illegible]
	Santa Monica	1,516 to 2,722
NORMAL DELIVERY (Hospital)*	Palm Beach	$ 1,125 to 1,26[illegible]
	Pittsburgh	1,125 to 1,299
	Santa Monica	1,068 to 1,262

*Top-ranked hospitals surveyed
**Estimate for plan participants with $1,000 individual deductible and coins[illegible] 10%
Data: Cigna

KNOW YOUR NETWORK

MOST PEOPLE ARE AWARE there's a cost incentive to stay in network. Just don't assume that every in-network provider gets the same reimbursement. In anticipation of turning 50 in March, Kate Scott decided to schedule her first colonoscopy. Because the Littleton (Colo.) financial adviser has a $5,100 deductible, she is especially cost-conscious. Yet after several hours of digging, Scott came up with in-network estimates that differed by $1,400, making her out-of-pocket costs $700 to $1,100.

If you must go outside your network, be prepared for another level of complexity, because you enter a realm where coverage is determined by what the insurer deems "reasonable and customary." For example, a New York City resident in a UnitedHealthcare plan can expect to shell out an estimated $667 for heart bypass surgery [illegible] performed in-network. Go out [illegible] work, and the out-of-pocket cost [illegible] to an expected $38,000. Figuri[illegible] how much of that is "reasonab[illegible] customary" is probably enough t[illegible] anyone a heart attack.

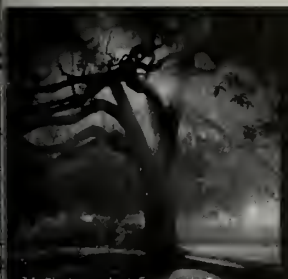
To avoid sticker shock when [illegible] an out-of-network provider, get [illegible] breakdown of a treatment or [illegible] dure, suggests Abbie Leibowitz [illegible] medical officer at Health Advoc[illegible] Blue Bell (Pa.) company that er[illegible] ers retain to help their workers r[illegible] insurance problems. Also ask [illegible] doctor has worked with your inst[illegible] company. If so, the physician's [illegible] may have a sense of what fee i[illegible] sidered "reasonable" as well as [illegible] won't be covered.

Once you have that informat[illegible] hand, see if the doctor is willing to [illegible] a lower fee. A Health Advocate cus[illegible] was billed $17,000 for an out-[illegible] work mastectomy and biopsy, of [illegible] just $2,700 was considered reas[illegible] and customary. With some ne[illegible] ing, Health Advocate got the surg[illegible] knock $7,300 off his fee.

Eventually health insurance cos[illegible] be more transparent. Until then [illegible] of us will have to doggedly purs[illegible] information we need to make sm[illegible] cisions about our health care. ■

BusinessWeek weekend For more on h[illegible] to be a smart health-care shopper, w[illegible] our weekly TV show, *BusinessWeek Weekend*. Check your local listings c[illegible] businessweekweekend.com.

Industrial Design



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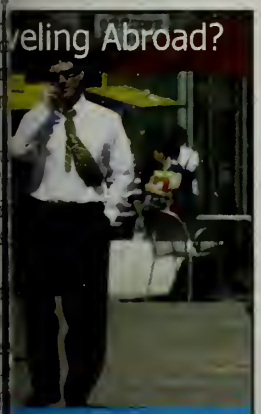

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BY GENE G. MARCIAL

WHY A BUYOUT MAY BE AHEAD FOR NORTHWEST AIRLINES.

AMETEK LANDS A HOMELAND SECURITY DEAL FOR ITS GEAR.

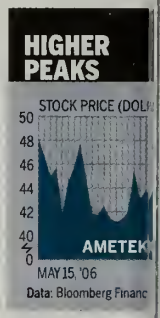
BATTLING CHOLESTEROL WITH A POTENT NEW WEAPON FROM I

Northwest Flies North

WHEN AIRLINE STOCKS tumbled last summer because of soaring fuel prices and a drop in traffic after the London terrorist-plot scare, Vincent Carino, president of Brookhaven Capital Management, turned bullish on the group. He bought AMR, parent of American Airlines, at 19, and United Airlines, at 23. They have since leaped to 31 and 36, respectively. Carino's new top pick is Northwest Airlines (NWACQ), now in bankruptcy and friendless on the Street. But shares of the No.5 carrier have spiked up–from 51¢ on July 7 to 1.75 on Nov. 15. Carino, who owns nearly 5%, and others who asked not to be named, say Northwest, with a market cap of $152 million, will probably be bought out before it emerges from Chapter 11. Some high-profile investors have been buying, Carino says, confident that private equity funds or another carrier will make a bid in three to six months. In a deal, they put Northwest's value at 5. On Nov. 15, US Airways made a surprise bid for Delta Air Lines, also in bankruptcy, for $8 billion (page 36). "The bid bolsters our case that Northwest could also get an offer," says Carino. Northwest posted third-quarter operating profits of $272 million on sales of $3.4 billion. From its bankruptcy, filed on Sept. 14, 2005, it had charges of $1.4 billion. With traffic and fares rising and oil prices down, Carino sees a "dramatic upswing in 2007 operating profits to between $500 million and $1 billion. Northwest expects a "modest" 2006 profit, excluding bankruptcy-related expenses. Mark Streeter of J.P. Morgan Securities says in a report: "It's possible that private equity could play a role in the Northwest exit financing." Historically, private equity airline deals have worked best, he adds, when the target was in Chapter 11, because of increased flexibility and lower valuations on the assets. Northwest didn't returns calls asking for comment.

Ametek: On the Alert For Radiation

WITH THE DEMOCRATS taking control of Congress, some investors expect speedier action on customs and border protection. They are betting on homeland-security stocks. One of them: Ametek (AME), a maker of electronic monitors that detect harmful materials. On Oct. 26 it won a contract from the Homeland Security Dept. to develop a portable radiation detector for customs, border patrol, and emergency services. Selection of Ametek's "high-purity germanium-based detector is a testament to its technology," says James Lucas of Janney Montgomery Scott. The initial $2.4 million deal, he says, could grow to $50 million in five years if the U.S. exercises all its options. Scott Graham of Bear Stearns gives the stock, now at 47.80, an "outperform" rating and expects it to hit 65 in a year.



ISIS Takes Heart From a Promising Drug

ISIS PHARMACEUTICALS (ISIS) is a name to watch the lucrative arena of cholesterol reduction. On No its stock soared 20%, to 12.43, after release of favor data on a new cholesterol drug at the American Heart meeting in Chicago. The stock is now at 10.84. The dru cut by 62% the levels of "bad" cholesterol in patients w took it for three months. "The robustness of the data is encouraging," says Mark Monane of investment firm Needham, who rated ISIS a "buy" six months before the results were released. He notes that the drug, which is taken by injection, "lowers cholesterol in a mechanism distinct from statins." Its safety profile, he adds, both as a single agent and in combination with statins, shows that the drug is "well tolerated," with only mild injection-site reactions. The data indicate that the drug warrants continued development as a powerful new addition to therapies for cutting cholesterol. The b drug for cholesterol is Pfizer's Lipitor, with annual sale of $14 billion. Aaron Reames of A.G. Edwards, who als rates ISIS a "buy," expects the breakthrough to contin generate "solid clinical data throughout 2007."

BusinessWeek.com Gene Marcial's Inside Wall Street is poste at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street n firms hold positions in the stocks under discussion. Similarly, they have no inve banking or other financial relationships with them.

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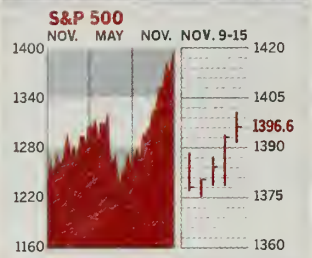


COMMENTARY

The S&P 500 neared the semi-magical 1400 mark for the first time since 2000. M&A activity continued to make the market percolate as US Airways Group made an offer for Delta Air Lines. Meanwhile, shares of Comverse Technology stumbled as the company found more accounting irregularities and their ex-CEO faced extradition from Namibia.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	NOV. 15	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1396.6	0.8	11.9	13.6
Dow Jones Industrials	12,251.7	0.6	14.3	14.6
NASDAQ Composite	2442.8	2.4	10.8	11.7
S&P MidCap 400	806.6	1.9	9.3	12.6
S&P SmallCap 600	402.3	2.5	14.7	17.2
DJ Wilshire 5000	14,020.1	1.0	12.2	14.3

SECTORS				
BusinessWeek 50*	792.1	1.8	6.8	7.3
BW Info Tech 100**	439.4	1.9	15.5	18.4
S&P/Citigroup Growth	648.8	0.9	8.8	10.1
S&P/Citigroup Value	745.6	0.6	15.1	17.3
S&P Energy	448.0	1.0	20.2	24.4
S&P Financials	481.8	0.6	13.0	14.6
S&P REIT	190.8	2.1	24.7	26.5
S&P Transportation	273.3	0.9	9.4	14.5
S&P Utilities	181.4	0.5	13.6	17.7
GSTI Internet	200.2	2.4	-2.4	0.8
PSE Technology	882.1	2.0	5.5	6.6

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS	NOV. 15	WEEK	% C YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1911.3	1.1	26.4
London (FT-SE 100)	6229.8	-0.1	10.9
Paris (CAC 40)	5511.5	1.4	16.9
Frankfurt (DAX)	6430.9	1.3	18.9
Tokyo (NIKKEI 225)	16,243.5	0.2	0.8
Hong Kong (Hang Seng)	19,093.0	1.5	28.3
Toronto (S&P/TSX Composite)	12,425.4	0.4	10.2
Mexico City (IPC)	24,315.6	1.6	36.6

FUNDAMENTALS	NOV. 14	WEEK AGO
S&P 500 Dividend Yield	1.77%	1.78%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.5	17.5
S&P 500 P/E Ratio (Next 12 mos.)*	15.1	15.0
First Call Earnings Revision*	-1.86%	-2.22%

*Fi

TECHNICAL INDICATORS	NOV. 14	WEEK AGO
S&P 500 200-day average	1298.2	1295.6
Stocks above 200-day average	71.0%	67.0%
Options: Put/call ratio	0.72	0.85
Insiders: Vickers NYSE Sell/buy ratio	4.84	4.42

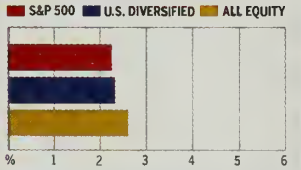
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Internet Retailers	27.8	Steel	94.4
Tires & Rubber	26.7	Agricultural Products	49.0
Photographic Products	18.3	Department Stores	44.2
IT Consulting	17.4	Divsfd. Metals & Mining	42.2
Consumer Electronics	17.3	Constr. Materials	39.0

WORST-PERFORMING GROUPS	LAST MONTH %	
Education Services	-31.9	Education Services
Computer Retailers	-9.6	Homebuilding
Constr. & Farm Mchnry.	-5.1	Health-Care Supplies
Paper Products	-4.6	Internet Software
Electric Mfg. Svcs.	-4.5	Managed Health Care

MUTUAL FUNDS

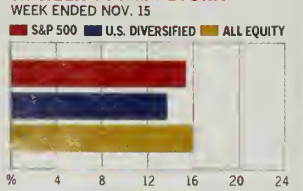
4-WEEK TOTAL RETURN

WEEK ENDED NOV. 15



52-WEEK TOTAL RETURN

WEEK ENDED NOV. 15



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	7.7	Precious Metals	50.3
Pacific/Asia ex-Japan	6.6	Latin America	42.4
Latin America	5.8	Pacific/Asia ex-Japan	36.8
Diversified Emerging Mkts.	5.7	Europe	34.6
LAGGARDS		LAGGARDS	
Japan	-0.6	Health	5.5
Health	0.1	Large-cap Growth	8.0
Real Estate	1.0	Japan	10.2
Financial	1.7	Mid-cap Growth	10.7

EQUITY FUNDS

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFds. Mble. Tlcmms. Inv.	16.6	Oberweis China Opport.	80.1
ProFunds Internet Inv.	14.1	U.S. Global Invrs. Gold	79.4
DireXn. Emrg. Mkts. Bull 2X	13.9	U.S. Glbl. Invs. Prc. Mnls.	79.4
U.S. Glbl. Invs. Prc. Mnls.	11.9	Midas	71.9
LAGGARDS		LAGGARDS	
American Heritage	-12.5	Ameritor Investment	-88.9
DireXn. Emrg. Mkts. Short	-12.4	DireXn. Emrg. Mkts. Short	-49.9
ProFunds UltSh. Emrg. Mkts.	-10.5	DireXn. Sm. Cap Bear 2.5X	-34.5
DireXn. NASDAQ 100 Bear 2.5X	-10.3	ProFds. UltSh. Sm. Cap Inv.	-29.9

INTEREST RATES

KEY RATES	NOV. 15	WEEK AGO
Money Market Funds	4.84%	4.84%
90-Day Treasury Bills	5.09	5.10
2-Year Treasury Notes	4.81	4.75
10-Year Treasury Notes	4.62	4.64
30-Year Treasury Bonds	4.70	4.73
30-Year Fixed Mortgage†	6.03	6.09

† Ba

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10YR. BOND	30
General Obligations	3.74%	
Taxable Equivalent	5.34	
Insured Revenue Bonds	3.83	
Taxable Equivalent	5.47	

THE WEEK AHEAD

LEADING INDICATORS *Monday, Nov. 20, 10 a.m. EST* » The Conference Board's index of leading economic indicators very likely increased by 0.2% during October, driven in part by rallying stock prices, a small decline in weekly initial unemployment claims, and a longer average workweek for factory employees. That's according to the median forecast of economists queried by Action Economics. The index climbed by 0.1% during September.

INITIAL UNEMPLOYMENT CLAIMS *Wednesday, Nov. 22, 8:30 a.m. EST* » New filings for state jobless claims probably rose slightly, to about 311,000 for the week that ended on Nov. 18. During the week ending on Nov. 4, jobless claims fell to 308,000. Initial and continuing unemployment claims have remained subdued, a sign that the labor markets remain pretty healthy despite the smaller-than-expected rise in payrolls for October.

CONSUMER CONFIDENCE *Wednesday, Nov. 22, 10 a.m., EST* » The University of Michigan's final consumer sentiment reading for November is forecast to have edged up to 93.5 from an initially reported 92.3 and come close to the October level of 93.6. Consumers feel better now that gasoline prices have eased.

The *BusinessWeek* productio slipped back to 283.7 for the ended on Nov. 4, an 8.9% gai a year ago. Before calculatio four-week moving average, t index fell to 282.8.

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ix Stages to Better Records Management

Within just the past few years, thousands of new laws and regulations have been passed to eliminate lax and illegal corporate management practices. The laws serve a *vital* purpose, of course, but they also create significant new burdens on millions of companies.

nsider:
The corporate litigation load has so swelled that the typical $1 billion company now must juggle an average of some 140 lawsuits at a time.
The average Securities & Exchange Commission (SEC) fine against corporations has skyrocketed by 400% since 2000, climbing from $1 million to $5 million per incident.
Sarbanes-Oxley (SOX) was designed to strengthen accountability in publicly held firms, imposes an average annual compliance cost of nearly $7 million, according to The Hackett Group, an Atlanta-based business consultancy.

ne Roadmap to Compliance

steep as these costs are, there is both comfort and hope he fact that all public and private companies face the ne new requirements and that, by working together to velop a sound strategic response, firms can minimize eliminate many of them. The most powerful tool that npanies possess in this regard is an effective "Compliant cords Management (CRM) Program"—that is, a program prudently manage corporate records and documentation. h an effective CRM program in place, companies are ter equipped to comply with the new regulatory requirents while operating their businesses with a minimum nterruption.

6 Stages of Compliant Records Management

According to Iron Mountain Incorporated, the Boston, ssachusetts, based leader in compliant records managent services, there are six critical stages in the roadmap building a successful CRM program. The first stage is to ***anize*** the program by carefully defining the program's ernance, implementation, and administration, ensuring these parameters precisely match the company's needs resources. The second stage is to assess the state of the company's current records program and to inventory the firm's physical and electronic records.

The Best Defense

The third stage in the roadmap for an effective CRM program is to ***develop*** a well-organized and easily understood classification structure that gives authorized managers easy access to corporate records at all times. When companies are called upon to submit a document, merely having it in the company's possession is not enough; the company also must be able to produce it in a timely fashion. Similarly, companies need to assign retention periods for records based on legal, risk, and operational considerations, and to create a consistent disposition policy.

The fourth, fifth, and sixth stages all relate to the CRM program's ongoing operation. Specifically, the program must be ***implemented***, typically in a carefully phased rollout that is accompanied by communication and training sufficient to build internal support. In addition, standard policies need to be implemented across media types, geographies, and business units. The program then needs to be ***managed*** on a continuing basis, and it must be systematically ***audited*** according to defined metrics in order to ensure its superior performance.

A Good Offense

By practicing responsible records management, companies can minimize compliance costs and adverse legal consequences even amid today's strict regulatory regime. Accomplishing this goal won't be easy. But the best defense is a good offense, and an effective CRM program is the best offense available.

To learn more about creating a successful Compliant Records Management Program, please download Iron Mountain's white paper "The New Corporate Imperative" at www.ironmountaincrm.com/bw

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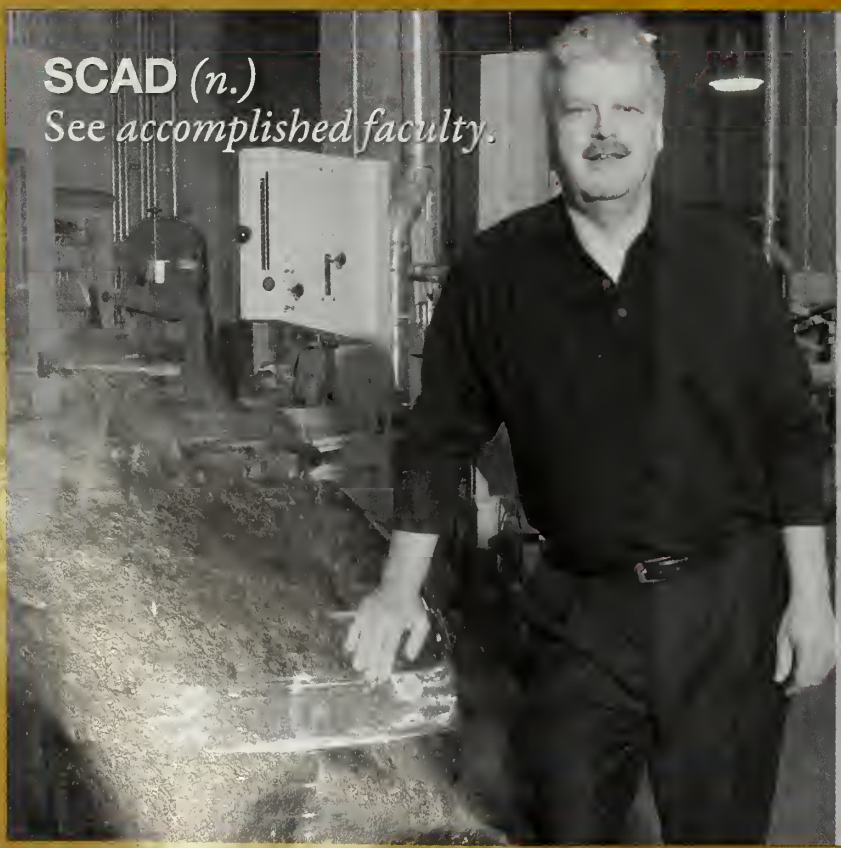

Joel Wittkamp
Professor of Industrial Design
Savannah, Ga.

As owner/CEO of an industrial design and engineering firm, professor Joe Wittkamp holds product patents with IBM, Rubbermaid and Dow Chemical. Current clients include Honda, Black and Decker and John Deere. Wittkamp earned a Master of Industrial Design degree from the Royal College of Art in London and teaches full-time at SCAD.

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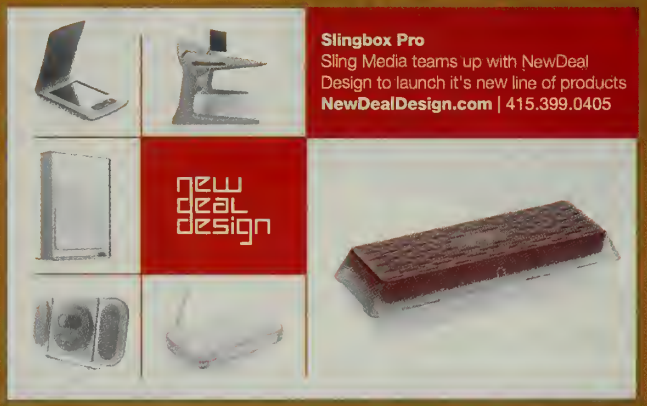

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Company Index

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A
ABC (DIS) **26**
Active Worlds **IN24**
Adaptive Path **IN4**
Adidas **50, IN17**
Adobe (ADBE) **IN26**
AdvancePCS (RMX) **62**
Aer Lingus **44**
AES (AES) **64**
Aetna (AET) **104**
A.G.Edwards (AGE) **62, 108**
Airbus **30**
AirTran (AAI) **44**
AllPeers **46**
Amazon (AMZN) **IN4, IN17**
American Apparel **IN17, IN24**
American Technology Research **60**
Ametek (AME) **108**
AMR (AMR) **108**
Anheuser-Bush (BUD) **66**
AOL (TWX) **26, 59**
Apax Partners **59**
Apple (AAPL) **16, 59, 76, 100, IN3, IN26**
ASA Consultants **13**
AutoNation (AN) **32, 64**

B
Bank of America (BAC) **IN40**
Bear Stearns (BSC) **66, 108**
BellSouth (BLS) **64**
Berkshire Hathaway (BRK) **20, 72**
BET **14**
Black & Decker (BDK) **50**
Blackstone Group **60**
Blue Marmalade **IN34**
BMW **10, 32, IN8, IN38**
Boeing (BA) **30, 44, 64, IN4**
Boyd Group **44**
BP (BP) **40**
BP Capital **72**
British Airways (BAB) **30**
Brookhaven Capital **108**
Bugatti **10**
Bureau Veritas **50**

C
Calcine Management **20**
Cali Bamboo **84**
Cal Safety Compliance **50**
Calvin Klein **14**
Calyon Securities **36**
Capital One (COF) **20**
Caremark Rx (RMX) **62**
Carlyle Group **60**
CBS (CBS) **26**
Cellular Communications **59**
China Resources Snow Brewery **66**
Chrysler (DCX) **32, 34**
CIGNA (CI) **104**
Cingular Wireless **24**
Cisco (CSCO) **IN26**
Citigroup (C) **30, 60, 82**
Clear Channel (CCU) **30**
CLSA Asia Pacific **34**
Cold Stone Creamery **IN8**
Conseco (CNO) **40**
Continental (CAL) **36**
CreditSights **36**
CVS (CVS) **62**
Cymfony **IN4**
Cyworld **IN24**

D
Daihatsu Motor **48**
DaimlerChrysler (DCX) **48**
Dealogic **40**
Dell (DELL) **30, 50, 64, 72, 76, IN17, IN26**
Deloitte Consulting **98**
Delta (DALR) **30, 108**
Design Continuum **IN4**
DeSilva & Phillips **59**
Deutsche Telekom (DT) **30**
Discover Financial (MS) **64**
Discovery Channel **59**
Doblin **IN4**
Dow Corning **IN4, IN26**
DuPont (DD) **IN4**

E
Eastman Kodak (EK) **IN26**
easyJet Airline **44**
eBay (EBAY) **72, 76, IN4**
Eddie Bauer (EBHI) **30, 50**
Edmunds.com **32**
Electrolux **IN12**
Electronic Arts (ERTS) **IN4**
Eli Lilly (LLY) **IN4**
Enron **40**
Enterprise Products **72**
ExxonMobil (XOM) **14, 64**

F
Fannie Mae (FNM) **16**
First American **16**
Fitch Ratings **60**
Flickr **IN4**
Ford (F) **32, 34, IN38**
Forward Concepts **60**
Freddie Mac (FRE) **16**
Freescale (FSL) **60**
Fuji Heavy Industries **34**

G
Gannett (GCI) **30**
Gap (GPS) **14**
Gartner Dataquest (IT) **60**
GE (GE) **30, 50, 118**
General Mills (GIS) **14**
GlaxoSmithKline (GSK) **40**
GM (GM) **32, 34, IN17**
Golden West (GDW) **72**
Good Technology **24**
Google (GOOG) **20, 46, 76, IN4**
Grameen Bank **76, 82**
Greycroft Partners **59**
Guangdong Development Bank **30**

H
Harbin Brewery (BUD) **66**
Harrah's (HET) **IN32**
Health Advocate **104**
Hertz **44**
Hewlett-Packard (HPQ) **50**
Highland Capital **46**
Home Depot (HD) **50**
Honda (HMC) **32, 48**
HSBC (HBC) **40**

I
IA Collaborative **IN36**
IBM (IBM) **30, 60**
Icosystem **IN4**
Innovaro **44**
Intel (INTC) **IN17**
Intelligent Energy **IN38**
International Game Technology (IGT) **14**
ISIS Pharmaceuticals (ISIS) **108**
iSuppli **16**
Isuzu **34**

J
Jaguar **44, IN38**
Janney Montgomery Scott **108**
Javelin Investments **50**
J.C. Penney (JCP) **50**
J.D. Power Asia Pacific (MHP) **48**
JetBlue (JBLU) **36, 44**
Jones Soda **IN8**
JPMorgan Securities (JPM) **108**

K
Kanebo **14**
KB Home (KBH)
KDP Investment
Kohlberg Kravis I **60**
Korean Air **30**
Kynikos Associat

L
Land Rover **34**
Lehman Brother **18**
Leo Burnett **IN17**
Linden Lab **IN17**
Liz Claiborne (LI **IN4**
L.L. Bean **58**
Lufthansa (DAL

M
Mangrove Capit
Maria Fiorina Ra **27**
McDonald's (MC
McGraw-Hill (M
McKinsey **IN12**
Mercedes-Benz **34**
Metroplex Toyot
Microsoft (MSF **42, 72, 76, IN4**
Mitsubishi Moto
Moody's (MCO)
Morgan Stanley **IN6**
Motorola (MOT) **60, IN4, IN26**
Mozilla **IN10**
MTV (VIA) **14, 5**
MySpace (NEW **IN17**

N, O
Napster (NAPS)
NBC Universal **2**
Needham **108**
Nickelodeon **59**
Nielsen BuzzMe
Nike (NKE) **50,**
Ningo Beifa **50**
Nissan (NSANY
Nokia (NOK) **24**
Nordstrom (JW
Northwest (NW **36, 108**
Novell (NOVL) **I**
NYSE (NYX) **30**
ObjectVideo **64**

Network **76**
RCL) **100, IN26**

ning **40**
a **84**
BAY) **IN24**
dvisers **60**
E) **108, IN4**
Airlines **30**
wes (PBI) **IN26**
14
2
Cruises **IN4**
Gamble (PG)

ve Insurance

zi **46**
dio **59**

46
3
nce
ogies **72**
In Motion
24
RTRSY) **IN17**
ton **IN32**
Group **IN4**
ips (PHG) **60**
YAAY) **44,**

(SAB) **66**
LD) **50, 58**
fe **IN17, IN24**
owell **IN38**

Corporate
sibility **50**
Footwear **50**
ster **14**
tems (ORCL)

AY) **46**
) **16, 30, IN4,**

(LUV) **36, 44**

tel (S) **42**

(SBUX) **IN8**
ediaVest **26**
(HOT) **IN17,**
32
16
ectronics
0
IN4
Salon **100**
V) **64**
tor **34, 48**

Target (TGT) **50, IN8**
Texas Instruments (TXN) **60**
Texas Pacific **60**
Timberland (TBL) **58**
Time Warner (TWX) **26, 100**
TiVo (TIVO) **IN8, IN32**
T-Mobile (DT) **24, 30**
Tough City **14**
Toyota (TM) **32, 34, 48**
Tribune (TRB) **26, 30**
Tuareg Capital **13**
Tyco (TYC) **40**

U
UAL (UAUA) **36, 108**
Union Park Pontiac **32**
United Gulf Industries **13**
UnitedHealthcare (UNH) **104**
Unitus Equity Fund **76**
US Airways (LCC) **36, 108**
U.S. Fiduciary Advisors **20**

V
Verizon (VZ) **IN26**
Verizon Wireless **24**
Viacom (VIA) **26**
Vietnam Air **30**
Virgin Group **IN40**
Vodafone (VOD) **44**
VoodooVox **59**

W
Wachovia (WB) **72**
Wachovia Trust **20**
Wal-Mart (WMT) **44, 50, 62**
Walt Disney (DIS) **50, 59**
Warner Bros. (TWX) **IN17**
Warner Music (WMG) **100**
Weight Watchers **42**
Wellpoint (WLP) **104**
Wells Fargo (WFC) **IN4**
Western Union (WU) **IN26**
Whole Foods (WFMI) **IN32**
Williams-Sonoma (WSM) **50**
Wipro (WIT) **IN6**

Y
Yahoo! (YHOO) **46**
Yamaha **IN38**
Yaris (TM) **32**
Young Sun Lighting **50**
YouTube **IN4, IN8**

Z
Zhi Qiao Garments **50**
Zhongshan Tat Shing Toys **50**
Ziba **IN4**

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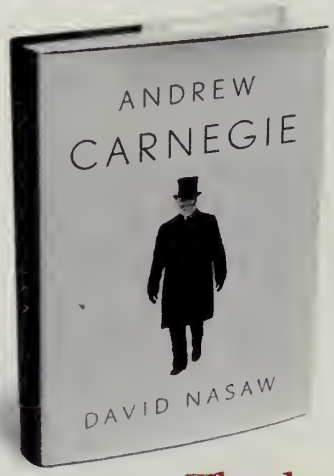
ANDREW CARNEGIE
By David Nasaw; The Penguin Press; 878pp; $35

By the time of his death in 1919, Andrew Carnegie had firmly established his reputation as one of America's greatest benefactors. Through active personal giving and several foundations, he had bequeathed a total of $350 million, or at least $8 billion in today's dollars. Libraries, of course, were a primary concern. Carnegie created 1,412 of them in the U.S. and more than 2,500 in the English-speaking world. His Carnegie Endowment for International Peace lives on today as an embodiment of his ideals—cooperation among nations, the redistribution of income, and wealth to be valued not as individual property but as a trust to be managed away.



Of all the Gilded Age magnates, philanthropy came most naturally to Carnegie. John D. Rockefeller became a major donor—but only after a public-relations expert, Ivy Lee, told him that donations could help salvage a damaged Rockefeller image. The Vanderbilts, Morgans, and Guggenheims came to an awakening late in life. By contrast, Carnegie began preaching the responsibility to give back beginning in his mid-30s, and it became a second career for him in retirement. But as biographer David Nasaw makes clear in *Andrew Carnegie*, his roles as philanthropist and rapacious businessman were closely linked. The "decision to give away all he earned...paradoxically encouraged him to be even more ruthless a businessman. Recognizing that the more money he earned, the more he would have to give away, he pushed his partners and his employees relentlessly."

Carnegie's lifetime of giving is a major theme in Nasaw's rich and absorbing story. Nasaw, a professor at the City University of New York and author of a heralded life of William Randolph Hearst, never quite makes it clear just how much of Carnegie's philosophy was the result of a socialistic Scottish upbringing and how much was camouflage intended to distinguish himself from other robber barons. In the end, it was probably a mixture of both.

Carnegie was 12 when he and his family emigrated from Dunfermline, Scotland, to the U.S. Unlike most in the great European migration of 1848, the Carnegies were not "ignorant peasants adrift in a strange, new world." They had relatives in Allegheny City, next to Pittsburgh, and in this coal-besotted industrial town, Andrew thrived. He moved from the factory floor to telegraph messenger bo Pennsylvania Railroad manager while a teenager. At 17, took his first public stand in a letter to *The Pittsburgh D* protesting a $2 annual library fee levied on working bo Nasaw makes much of this, noting that Carnegie by the a "man's job," earning $25 a month. But in arguing foı libraries, he was already revealing "a talent for cloaking interest in larger humanitarian concerns."

There are scores of such revealing details in Nasaw's volume. Carnegie was as much of an ironfisted capitalis any other Gilded Age mogul. He did his best to monopo steel production, fix prices, restrict foreign steel with ta and maximize state and local subsidie the rail business. Even though he prea equality for the working man, he mor once used Pinkerton agents to break s culminating in the infamous Homeste (Pa.) lockout and pitched battle of 189 which 16 died. He extolled leisure for he fought bitterly against demands to steelworkers' 12-hour days to 8 hours

Through much of his career, Carnegi campaigned for disarmament and worl peace. Meanwhile, he made steel for gu and ship armor, arguing it was better th rather than others, profit since he plann to distribute his wealth. When he neede more land in Pittsburgh, he indirectly b politicians to get it.

> The decision to give away everything he earned encouraged Carnegie's ruthlessness

By 35, Carnegie had beco absentee owner. He plunged a second career as a writer a advocate for his causes. Two his books, *Autobiography* an *Gospel of Wealth*, helped defi image as a humanitarian.

During his later years, Carnegie's steel empire wa investigated for industrial violence, tax fraud, and bribery. But by then he had "reinvented himself as a fu philanthropist." Appearing a congressional investigati committee in 1915 with John D. Rockefeller, Carnegie " the show," declaring, "My business is to do as much g the world as I can." In the end, his great regret was th couldn't give away everything during his lifetime.

Samuel Clemens, a friend, described Carnegie as a l man who "looks smaller than he really is." But even b standards of today's megabillion givers, he overshado everyone in preaching the obligations of wealth. ■

–By Bob D

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BY RICHARD SCHMALENSEE

Where's the 'B' in B-Schools?

To our critics, including many successful managers, business schools have become little more than exercises in ticket punching for would-be consultants, taught by faculty who are more interested in impressing th academic colleagues than in confronting real-world business problems. Although overstated, this caricature has a grain of truth. In response,

many business schools, including my own Massachusetts Institute of Technology Sloan School of Management, are seeking to make our research and teaching more valuable to practicing managers. This is easier said than done.

Ironically, the recent criticism—that the MBA curriculum emphasizes analysis (what to do) at the expense of management (how to get it done)—is a sign that the last revolution in management education, which began in the late 1950s, was too successful. By bringing the methods and rigor of traditional academic disciplines such as economics and psychology into management research and education, that revolution substantially advanced the practice of management.

But now, management school faculty often focus on academic fields such as game theory or econometrics, not on management practice, and their work may have little to do with real business problems. And as business faculty have sought ever more academic status, describing what managers actually do has tended to crowd out prescriptive work on what they *should* do.

Critics charge that such faculty (some who may not even know or care much about business) can teach business students little or nothing about how to actually manage–in other words, to accomplish things with and through other people.

It's in the interest of both business schools and managers to bridge this divide. Management schools need to engage thoughtful practitioners in research-based, problem-driven endeavors to improve both the teaching *and* practice of management.

Unfortunately, under the current academic reward system, what matters most is having an impact among peers, mainly by getting specialized research published in influential journals. The system isn't designed to evaluate or reward someone who invests significant time in the field learning about industry X and working on its problems, even though that investment may produce a superb observer of what's happening in the field who then brings that direct know to bear on both their teaching and research.

Even after faculty get lifetime tenure, if they veer fro the traditional academic path, they will likely lose statu within the academy. Few have a strong enough ego not to care. At the core of management school criticism, then, is a fundamental mismatch: the academic system current methods for hiring and rewarding professors d necessarily attract or encourage the kind of practitioner oriented faculty we need to make business-school resea and MBA education much more attuned to meeting tod and tomorrow's management challenges.

Publishing specialized research counts for more than real-life experience

Solving this core problem will require a effort not just at MIT Sloan, but at all busi schools. Many are willing and anxious to s this problem, but, like me, are not quite ce how to do so.

Part of the answer is for business studer to learn more about business directly from practitioners. Former General Electric Chi Executive Jack Welch's class at MIT Sloan, on his management best-seller, *Winning*, i example of this. In addition, we are reeval our MBA curriculum to focus it—and the students/future managers we are educatin more sharply on emerging challenges in the areas of globalization, sustainability, entrepreneurship, and innovation. We are experimenting with promising new ways to develop st abilities to manage and lead.

In the longer run, however, relationships between business schools and business professionals must exte beyond individual classes or programs. And business s research agendas must become primarily driven by rea life management problems. But in order for this chang happen, problem-driven research must become recogn and honored as a great way to advance, not jeopardize, academic career. ■

Richard Schmalensee, *John C Head III Dean of the MI School of Management, will step down as dean next spring*

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IdeasTheWelchWay

BY JACK AND SUZY WELCH

Call It Work-Life Choices

Is it possible for a leader to be a top performer and still achieve work-life balance?

–Christy Dobbs, Philadelphia

Not only is it possible, it happens all the time.

Look, top performers are top performers for a reason. They're usually very talented: smart, creative, productive, and loaded with energy. And those qualities don't tend to confine themselves to work. If they're truly in a person, they suffuse everything he or she does. That's why we all know plenty of successful businesspeople who also have successful lives outside work, filled with family, volunteering, and hobbies. They've figured out what they want and how to make it all happen, usually with the help of well-honed "home processes" such as meticulous scheduling and back-up child care.

We take your question, though: We've heard it dozens of times. In a global economy wherein job challenges are constantly escalating, it is easy to feel overwhelmed by conflicting demands. And technology complicates matters. With your BlackBerry in hand, you can constantly be on call for everyone. But feeling swamped is really just a default mechanism: It's what occurs when you don't face what "achieving work-life balance" really comes down to, which is making choices and living with their consequences. In fact, we would even vote to retire the term "work-life balance" and replace it with "work-life choices."

> Forget the idea of "balance." There is no single right way to divide work and personal time

The problem is that "work-life balance" suggests there is one right ratio for how much time you spend working and not working, and we disagree with that. Sure, there's a lot of politically correct advocacy for a kind of perfect equilibrium, and it may well be that many people want a 50-50 split between work and life. But some people love work so much and find it so gratifying that they want to live a different equation, like 70-30, say. Still others want to work just enough to support a life of avocation. We have a friend who writes and consults about two months a year to pay for travel the other 10 months. He thinks his life is perfectly balanced.

Balance, we're saying, is a personal choice based on what feels right to you given what you want from life personally and professionally. With that choice comes consequences. When you choose to work 80 hours a week and you have a family, you're also choosing to give up some level of intimacy with your spouse and children. When you cho to work 35 hours a week in order to see more of them, y also choosing to take yourself off the fast track to senio management. There's no right or wrong here. There ar individual choices and their trade-offs.

That said, we do acknowledge that work-life balanc usually a much harder goal for women with children. them, there is about a 15-year period in their careers i which the choices they make are not about what they from life professionally and personally but about wha right for their kids. It can be a fraught time, since cho and consequences are more complex. That, however, i topic for another column.

But to your more general question: Yes, it is complete possible to be a top performer and achieve work-life bal Most top performers have already made a choice—work a priority—but their talent helps them forge a meaningf outside life, too, often with just the balance they want.

In a matrix environment, how can a functional boss give evaluation to a person whom he doesn't see very often?

–Anonymous, Ba

He can't. And in fact, your question nails one of the big problems with matrix organizations. For all the good t do in terms of productivity and knowledge-sharing in product-line companies, they can really fuzz up reporti relationships. And that lack of clarity can drive worker nuts, especially when it comes to performance reviews you, employees want to know how they can be evaluat someone who barely knows what they do.

Here's a solution to consider. Functional heads in m organizations should start thinking of themselves as q temp agencies. Instead of trying to manage functional specialists in the product groups from a distance, they focus on hiring those specialists, training them, deplo them to the right jobs in the organization, and, with th product heads, reassigning them when and if a better becomes available.

True, under this new approach, functional heads wo have input into any given specialist's performance eval But the bulk of that responsibility would be held by pro line managers, where, for clarity's sake, it belongs. ■

Jack and Suzy Welch look forward to answering your questi about business, company, or career challenges. Please e-mai them at **thewelchway@businessweek.com.** *For their we podcast, go to www.businessweek.com/search/podcasting.ht*

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The Soul of a New Microsoft

Edgy thinkers like J Allard are looking far beyond Windows for the next big thing

BY JAY GREENE (P.56)

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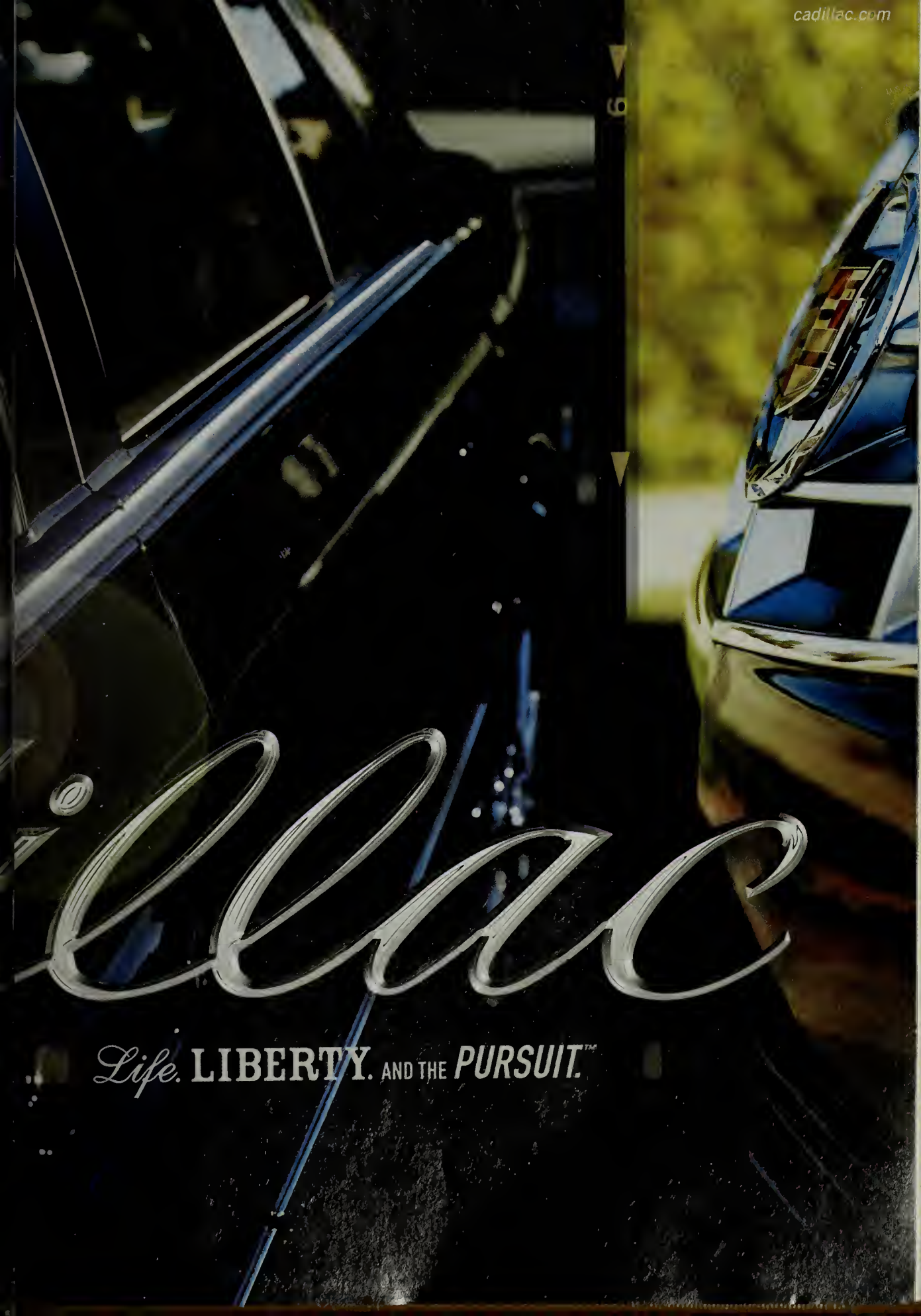
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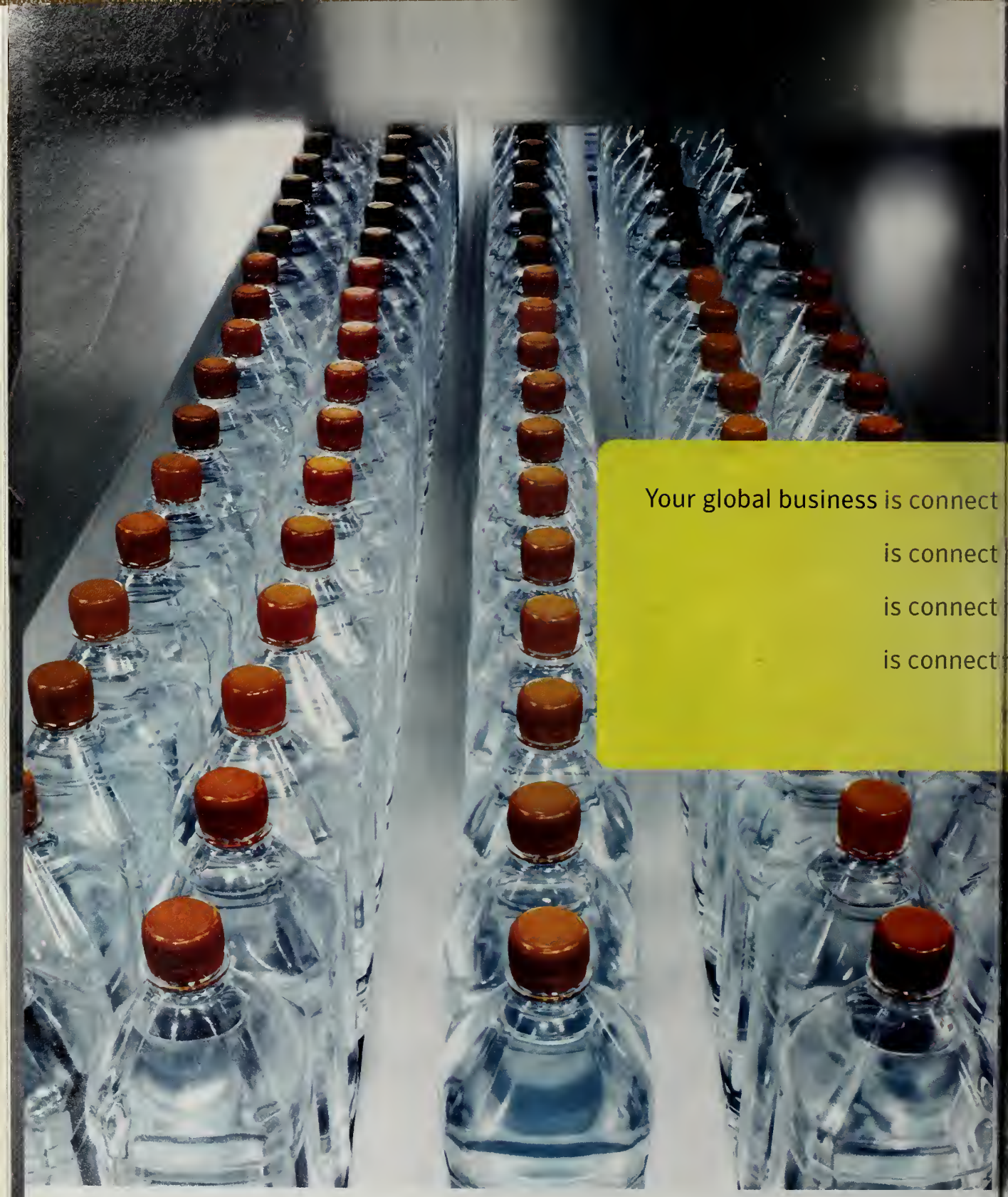

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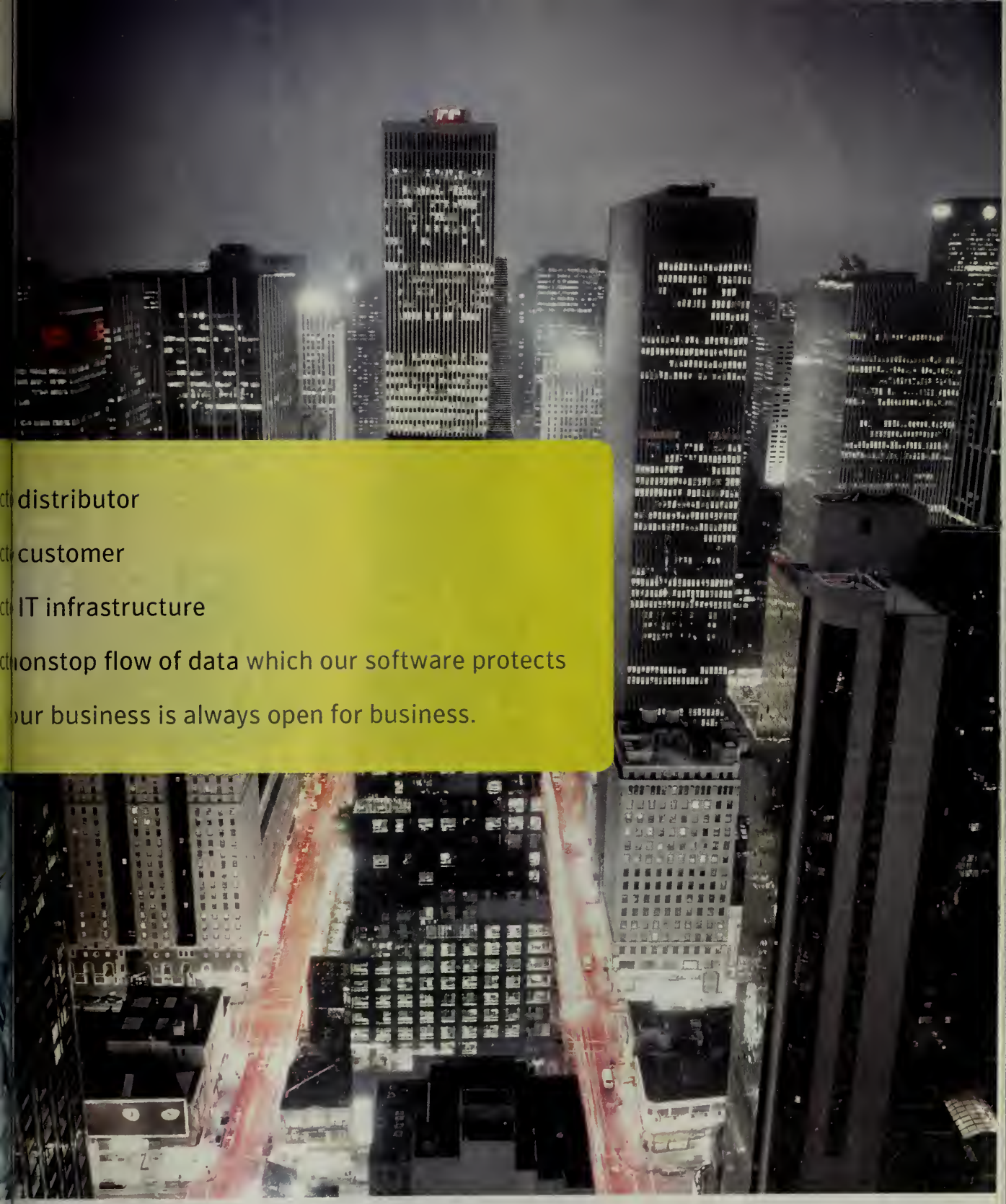

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pite the Net, they're more popular ever—and learning new tricks

The Mall Wars Get Ugly
ironmental rules and a lack of space e moguls at each other's throats

Sam Zell's Best (Worst?) Move Yet
et his REIT go for what looks like a gain price. What's going on?

Splurging on Merging
h stocks cheap and buyout firms n, this M&A boom may break records

MySpace, My Way
v social network sites have limited ess. And that suits some people fine

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gining a post-Thanksgiving buying ge—with a $155 billion market cap

obal Business

***Sturm und Drang* at Volkswagen**
er November's boardroom drama, o is really in charge?

NASDAQ's Siege of the City
London Stock Exchange may not be e to evade its pursuer

Pulling Up Korea's Welcome Mat
eans are infuriated by the huge fits of foreign private-equity firms

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Special Report

56 The Soul of a New Microsoft The software giant is embracing the need for innovation in a Web-centered world, and it's giving a team of edgy thinkers like J Allard the go-ahead to look far beyond Windows for the next big thing

66 Redoing the Office And polishing the Windows: Kevin Johnson and Jeff Raikes on why updates were needed

FUTURE OF TECH

68 A Mobile Revolution New, superfast networks are about to utterly change your wireless life. Get ready for a flood of gadgets and services that will keep you more connected to friends, family—and advertisers

81 Big Chance for Small Biz Washington's proposed network upgrade could be a windfall

CONTENTS

The Corporation

50 Where Six Sigma Really Pays Off
The quality program is a godsend for Motorola

The Best Performers

Media

54 You Oughta Be in Webcasts
Scripted Internet shows are luring advertisers and indie filmmakers alike

Managing

84 Delta's Flight Plan
Can CEO Grinstein and his team save the carrier from US Airways' advances?

Finance

94 Duane Reade: A Sickly LBO
How it landed on the critical list

People

96 Lighting a Fire Under Campbell
Doug Conant's cerebral style pays off big

Health

102 About Those Health Benefits
Retirees may find promises from states, cities, and school districts unkept

B-Schools

106 The Trouble with China's MBAs
Businesses are unimpressed with them

Workplace

109 Enough with the E-Mail
Face-to-face meetings stage a comeback

Deals

110 Love Those Voile Sheets
Private equity bets on French brands

Executive Life

114 Wrist Candy for the Punctual
The hottest watches of the season

116 Audi's Smooth Operator
The Q7 is an SUV with a sports-car ride

119 Clever Carry-Ons for the Road
Luggage to make business travel easier

Personal Finance

124 December Tax Tips
Five problem areas to straighten out now

128 A Dearth of Deals
Closed-end investors aren't selling much

128 Watch Those Fund Distributions
Why pay taxes if you don't have to?

130 Figures of the Week

132 Inside Wall Street
Gene Marcial's stocks to watch

Ideas

138 Books
Gabler: *Walt Disney*

Columnists

18 Kerry Sulkowicz: Analyze This
Steamed by the small stuff

22 Steve Wildstrom: Tech & You
PlayStation 3: It's got game

26 Jon Fine: Media Centric
New Media lessons from London

120 Jonathan Schwartz: My Tunes
Sinatra, the Beatles, now Tierney Sutt

122 Robert Parker: On Wine
A reason to veer off the Chianti trail

142 Maria Bartiromo: Face Time
Italy's Romano Prodi opens up

144 Jack and Suzy Welch: The Welch W
Don't play the office cop

Features

13 UpFront

20 Readers Report

136 Index to Companies

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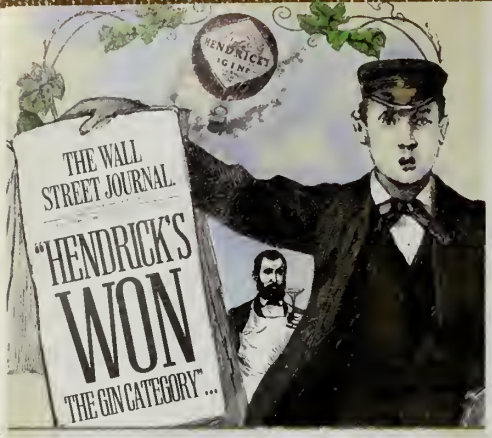

THE WALL STREET JOURNAL.

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FRIDAY, AUGUST 29, 2003 – VOL. CCXLII NO 45 ~ ★★★★ $1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
TOP 3 GINS	
Hendrick's $30/750ml	Most Flavorful
Tanqueray No. Ten $26/750ml	Smoothest
Juniper Green Organic $26.50/750ml	Best Presentation

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What's Hot This Week A

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The Corporate Mashup

Not long ago mashups were the realm of the digitally adept who wanted to combine and remix parts of **unrelated Web sites** to fashion something that was more to their liking—or to impress friends. Now that homespun movement is making its way into the corporate world as companies seek faster, cheape ways to build customized software. BusinessWeek.com's **CEO Guide to Technology** tells how companies like E*Trade, Siemens, and Pfizer are using mashups to boost employee productivity. E*Trade CIO Greg Framke also explains how he uses them to offer **innovative financial services.** See how online music service Last.FM puts mashups to work, quickly adding features to its site to help it stay competitive. And watch a **Video View** with IBM's David Boloker as he describes how, after Hurricane Katrina, Big Blue helped the U.S. Chamber of Commerce creat a job board that combined listings with maps for Gulf Coast residents. Then find out how mashups are **going mobile in Asia,** with carriers, handset makers, and consumers mixing togethe different features in mobile devices. For all this, and more, go **www.businessweek.com/technology/ceo_guide.**

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UPFront

"Never was there a less dismal practitioner of a dismal science."

–Former British Prime Minister Margaret Thatcher on the passing of Nobel Prize winning economist Milton Friedman

TED BY DEBORAH STEAD

TAIL DETAIL

REVIVAL AY NOT BE STORE

ARTMENT STORES led the e il pack in same-store s gains last month, tinuing a rise this year has generated hoopla ut the long- ng industry's val. But the res, for sales tores open east a year, deceiving. erybody is ing about how artment stores showing all this wth," says Marshal Cohen market researcher NPD up. "That's bull." ranted, those same- e sales surged this year, raging 4.1% monthly ns through October, rly double the rate of a ago. At No. 1 Federated Department Stores, owner of Macy's and Bloomingdale's, such sales rose 7.7% last month. But a huge industry consolidation has artificially inflated those numbers, analysts say. As department store outlets close, business tends to shift to remaining department stores. Says ThinkEquity Partners analyst Edward Weller: "The natural place for those sales to transfer is to the 'most-like' stores nearby."

Deutsche Bank analyst Bill Dreher estimates that $2.9 billion in annual sales has been up for grabs as a result of 133 store closings by Federated and the Mervyns chain just in the last year. So remaining stores got bigger pieces of a shrinking pie: Overall department store sales this October fell by $400 million, to $17.6 billion, from a year earlier. Not much holiday cheer here.

–Robert Berner

THE BIG PICTURE

ONLY 38% of U.S. online consumers think it's safe to buy software online. Still, 46% do so, with mixed sults. About one-fifth of ose who bought software line in a recent 12-month riod reported problems, ong them:

Product differed from order	53%
Software did not work	36%
"Immediately discovered" software was pirated	14%
Never received product	12%

Data: Business Software Alliance, Forrester Research Inc. survey of 5,071 U.S. individuals polled in August and September

BMW X5 A hefty break on leases

OFF THE LOT

Guess Who's Cutting Deals

HERE'S YOUR auto biz quiz: Which carmaker spent the most money per vehicle in October on customer incentives? If you said Ford or General Motors, you're wrong. If you think it's Chrysler, you're close, but wrong again. Believe it or not, it's BMW. The company started to spend more on incentives over the summer, but it really sweetened the deals in October. According to auto site Edmunds.com, givebacks cost BMW an average $4,179 per car during October, more than Chrysler's $4,136 a vehicle and more than twice what German rivals Audi and Mercedes-Benz are spending on incentives.

It's not a matter of cash on the hood. When BMW cuts deals, it subsidizes leases, which make up at least 60% of its U.S. sales. The carmaker is offering almost $10,000 in lease subsidies for its flagship 7 Series sedan, Edmunds says, and $6,500 worth of lease support on an X5. Even the 5 Series, with sales up 5% this year, has almost $5,700 in lease subsidies.

Frank Ursomarso, who owns a BMW dealership in Wilmington, Del., says you can drive a new 530i sedan for $489 a month—not much more than what you'd pay to get in the smaller Audi A4. The company says there are good reasons for the deals: a soft car market and the fact that the X5 will be replaced soon. (BMW wants to shed inventory of the old model.) But that explanation doesn't hold for the 7 Series and 5 Series, the current generations of which are less than three years old.

The deals might not last. Executives get their bonuses in December, and Bimmers tend to fly off the lot. So now may be the time to hit the showroom.

–David Welch

WEB WORLD

JAPAN'S FRIEND NO. 1

Tom Anderson, the co-founder of MySpace, is the first to greet the site's 78 million users, installing himself as Friend No. 1 on their profiles and sending memos on how the site works. The role is crucial to forming a community, and as the site has expanded globally, Tom, as MySpacers feel entitled to call him, has played it in Australia, Britain, France, Germany, and Ireland.

But when the Japanese MySpace launched on Nov. 15, users were greeted by someone else: Ozzie Inoue. On the advice of its Japanese partner in the venture, Softbank, MySpace is trying to be culturally relevant in Asia. The switch to Ozzie, who is Japanese, is part of that. So how do Tom and Ozzie compare? Let's consult their profiles: Tom, 30, is a Libra from Santa Monica, Calif. Ozzie, 36, is an Aries from Tokyo. Ozzie is blaring *Lost in Your Eyes* by vocalist Deborah Gibson on his profile. Tom has posted Mickey Avalon's *So Rich, So Pretty*. Ozzie is married, Tom is single. Tom has 130 million friends. Ozzie? Just 51,470 —so far. *–Jessi Hempel*

MEDIA DEALS

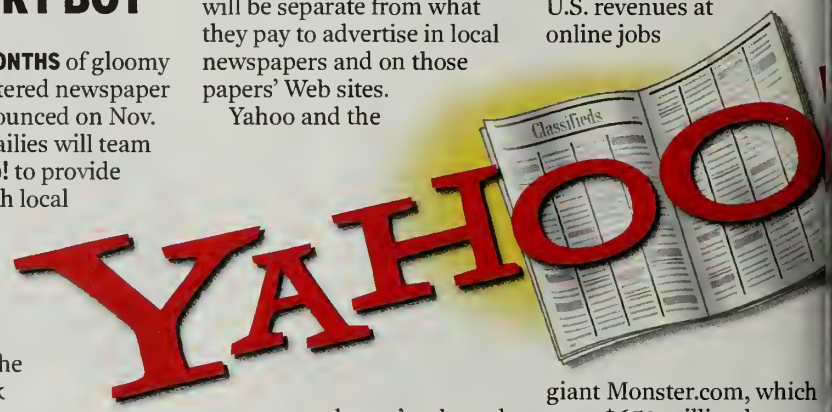
NEWSPAPERS' NEW ONLINE DELIVERY BOY

FOLLOWING MONTHS of gloomy news, the battered newspaper industry announced on Nov. 20 that 176 dailies will team up with **Yahoo!** to provide the portal with local classified advertising, a first step in a broader sharing agreement. The pact may look as if publishers are admitting defeat by handing over an important (albeit much reduced) revenue stream to their nemesis, the Internet.

But that's not so, say the publishers. "Everyone thinks we are shifting revenues to HotJobs," says Lincoln Millstein, a senior vice-president at **Hearst Newspapers.** "Why the hell would we do that?" In fact, it's the newspapers that will reap most of the incremental fees that local employers will pay to have their "help wanted" ads also posted on Yahoo! HotJobs. The amount will be separate from what they pay to advertise in local newspapers and on those papers' Web sites.

Yahoo and the newspapers haven't released details, but Robert Jiranek, vice-president for sales and strategic planning at one of the newspapers, *The Commercial Appeal* in Memphis, says the split will be 80% for newspapers and 20% for Yahoo. "It's good for us because we need to extend beyond print," he says. "And it's good for Yahoo because it gives it a toehold in local advertising."

Newspapers could sure use the lift: Revenues from help wanteds fell 42% from their peak in 2000, to $5.1 billion in 2005, says researcher **Corzen.** Meanwhile, U.S. revenues at online jobs giant Monster.com, which were $650 million last year are expected to grow by as much as 15% this year.



If that's not enough to send tremors through publishers, a larger fear, for both newspapers and Yahoo is **Google's** plan to move into local advertising. "Our deal with Yahoo was not motivated by fear of Google per se," says Millstein, "but it is an acknowledgement that the world is changing very quickly." *–Tom Low*

GLASS CEILINGS

CORNER OFFICE CRAWL

DESPITE advances in the corporate sphere, it's still lonely at the top for female CEOs—and will be for at least another decade, predicts a study by **Dartmouth's Tuck School of Business** and **Loyola University Chicago.** Researchers looked at proxy statements and **Securities & Exchange Commission** reports from the 942 largest U.S. companies in 2000. They gathered biographical data about executives and categorized them by gender, age, tenure, and "corporate level," from what they called Level 1 (CEO or chairman) to Level 5 (a subsidiary's vice-president, for instance). Assuming executives move up one rank every five years or so—a rate the study's authors call "perhaps optimistic"—the researchers predicted the rate at which female executives at these companies will move through the pipeline to become CEOs. *–Elizabeth Woj*

Proportion of female CEOs, 2000 to 2016:

2000	2006	2010 (est.)	2016 (est.)
0.6%*	2%**	4.9%	6.2%

*Includes board chairs as well as CEOs. **Actual figure for top 1000 companies. The study's formula predicted 1.7% for 2006.
Data. Constance E. Helfat and Paul J. Wolfson of Dartmouth's Tuck School of Business and Dawn A. Harris of Loyola University Chicago. "The Pipeline to the Top: Women and Men in the Top Executive Ranks of U.S. Corporations," *The Academy of Management Perspectives*, November, 2006.

While Utah has some lovely ski trails, we go for the airbags.

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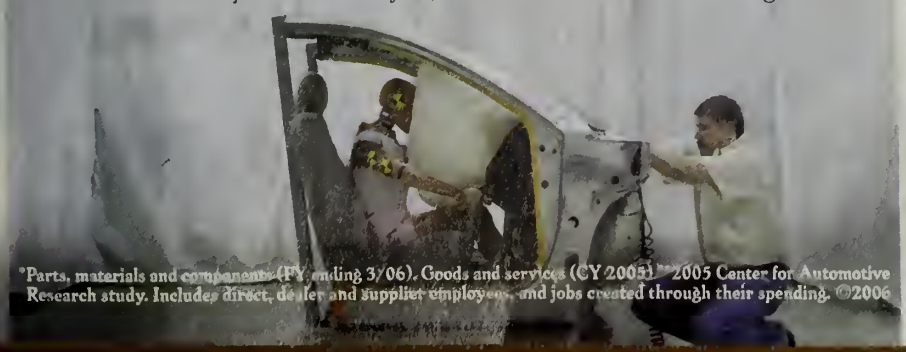

*Parts, materials and components (FY ending 3/06). Goods and services (CY 2005). **2005 Center for Automotive Research study. Includes direct, dealer and supplier employees, and jobs created through their spending. ©2006

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LEGAL MATTERS

WHAT SPITZER LEAVES BEHIND

AS NEW YORK Attorney General Eliot Spitzer prepares to take over the governor's office in Albany, business is fretting that his legacy of hardball tactics will linger.

As AG, Spitzer adopted a strategy used by the **Justice Dept.:** Strong-arming companies into refusing to pay legal fees of indicted employees as a condition of avoiding a corporate indictment. Business groups, along with the **American Civil Liberties Union,** have been lobbying Congress to stop Justice's practice, and Senate Judiciary Chairman Arlen Specter (R-Pa.) and ranking member Patrick Leahy (D-Vt.) may introduce a bill this month. The mounting political pressure has Justice weighing changes to its policy.

SPITZER

But "we may still have a residual problem at the state level," says Susan Hackett, senior vice-president of the **Association of Corporate Counsel,** noting that state AGs have watched Spitzer succeed with the strategy. Nine of 17 recent deals Spitzer struck with accused companies prohibit the businesses from paying indicted employees' legal fees, according to *Corporate Counsel* magazine. Among the nine: **Bank of America, Federated Investors,** and **Strong Capital Management.** New York's incoming AG, Andrew Cuomo, declined to comment on the issue.

–Lorraine Woellert

ADS PEOPLE PLAY

MOST VIDEO GAMERS are male, but they're no all adolescents. The average console-game player is 26, old enough to have an income and smack in the middle of the coveted 18- to 34-year-old demographic. Small wonder that advertisers are increasingly eyeing video gam In-game advertising, expected to triple this yea over last, to $164.7 million, is on track to hit $7 million by 2010, says Yankee Group Research. Ubisoft Entertainment's recently released *Ton Clancy's Splinter Cell: Double Agent* (above) promotes Nivea for Men and Philips Norelco's Cool Skin razor—through product placement and billboard ads in outdoor scenes. A Web address in those ads directs players to a site th offers game tips. *–Lindsey Gerdes*

BLOGSPOTTING

A BIG BLUE BRAIN

irvingwb.typepad.com

»WHY READ IT: Because the guy who led **IBM's** Internet, Linux, and next-generation Web initiatives should have something interesting to say. And quite often he does. Irving Wladawsky-Berger, the company's vice-president of technical strategy and innovation, is charged with figuring out which technologies and market shifts will matter to the future of IT. To be sure, he hypes IBM initiatives in this blog. But his sharp posts—on everything from his Second Life virtual world experience ("Irving in Wonderland") to the state of innovation in Latin America—are worth it.

–Jena McGregor

INNOVATIONS FOR THE mailstream

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ANALYZE THIS BY KERRY SULKOWICZ, M.D.

Getting Steamed by the Small Stuff

When I'm confronted with incompetence —in the work of subordinates, colleagues, or even suppliers—my annoyance can quickly escalate into anger. I'm then unable to communicate what I want. Strangely, I get even more impatient when the competence gap is small or the task at hand is a minor one. How should I be responding to the mistakes people make?

V.H., Pune, India

NO ONE LIKES incompetence, but the mistakes you're encountering are clearly touching a raw nerve in you. The problem isn't just the intensity of your anger. It's also the harshness of your judgments.

The key to changing your response is to get some insight into what triggers your rage. And one clue to understanding what's going on here is your helpful admission that you react even more strongly to the small stuff. My best guess: You're projecting onto others an intolerance you have for anything less than perfection in yourself. You then respond with the same punitive attitude you may have toward yourself when you make mistakes on something you consider simple—errors you think there's no excuse for.

Because of this harshness, which you may have learned the hard way by being on the receiving end of it in childhood, you also appear to have developed an over-inclusive definition of "incompetence."

Don't you think there's a difference between making a mistake and being incompetent? In your eyes, it seems, errors exist on a continuum that leads to a global indictment of one's character. Intellectually, you might agree that to err is human, but emotionally you're unforgiving.

IF THESE INSIGHTS make sense to you, try after some reflection, to remind yourself o them the next time someone around you messes up. Holding your anger in check w take some deliberate self-restraint for a wh until greater self-awareness sinks in. But ir time you should have more control over yo responses as a more tolerant attitude, tow your own mistakes and those of others, sta to kick in automatically.

In the meantime, distancing yourself physically may help keep things cool. Don' hover or stay on the phone after pointing o an error; just make a plan to check back in with the subordinate, vendor, or colleague in question after the work is corrected. And if you do blow up, you might consider apologizing. Among other things, it may produce an unexpected payoff: fewer error People who are intimidated by anger, after are probably more likely to make mistakes

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executi on psychological aspects of business. Send h questions at analyzethis@businessweek.com

QUESTION OF THE WEEK

If US Airways succeeds with its hostile bid for Delta, creating the largest carrier, what would both parties have to do to build a truly successful airline? *–Dean Foust*

"They'd have to cut costs significantly—reducing Delta's pension commitments, for instance. And since neither airline is known for quality customer service, they'd need to improve. And expand internationally, especially in Asia."

John Kasarda, director, Kenan Institute of Private Enterprise, University of North Carolina

"They should go with Delta's fares and US Airways' mileage perks. And start paying attention to the international business-class traveler, who is any serious carrier's bread and butter. Delta's been in the can in this area."

Matthew Bennett, editor, FirstClassFlyer.com

"Both of these airlines have long neglected their most valuable asset, their people. They'd have to bring them back into the fold to provide superior service. And they'd need to create a consistent, powerful brand image."

A Delta 767 pilot based in Los Angeles who asked not to be identified

Ryerson Saw the Future of Metal Processing.
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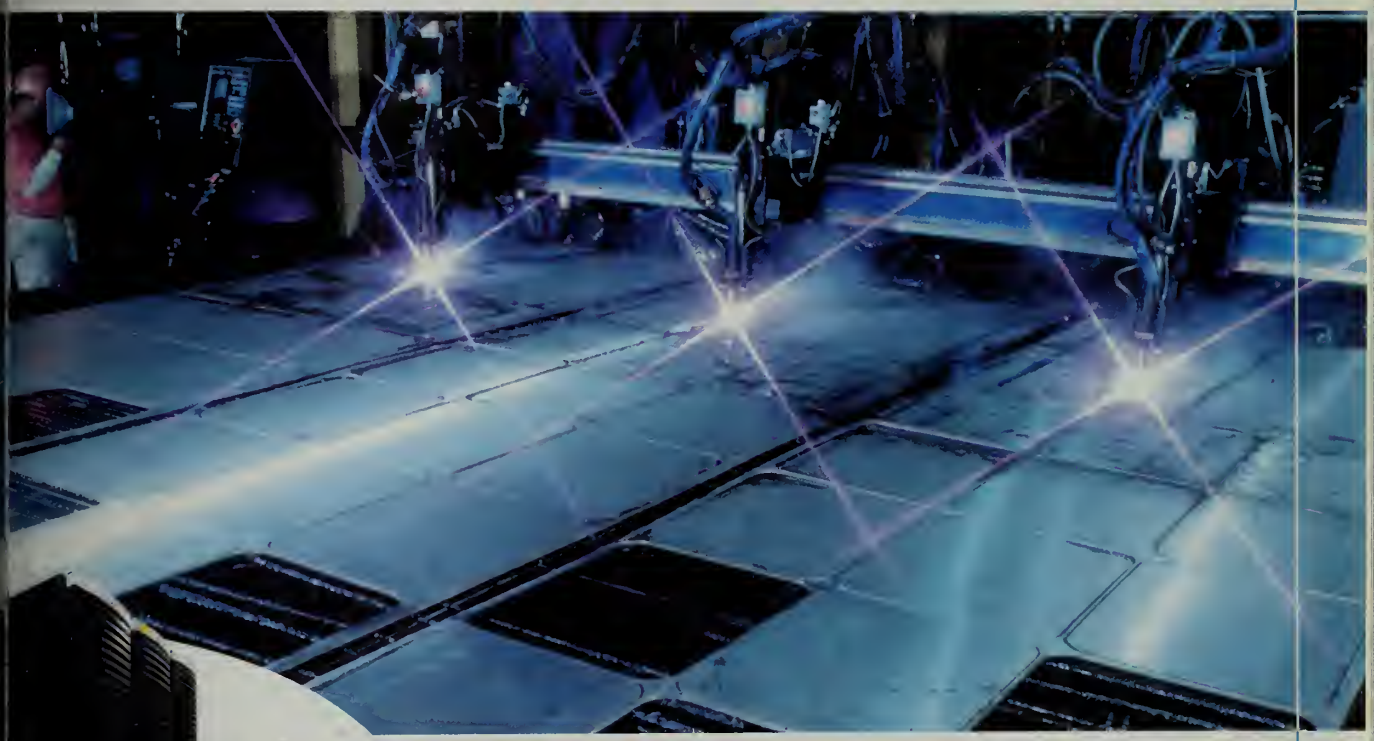

Metal—steel bars, aluminum sheets, stainless plates—is the ultimate hardware. But for Ryerson, software can be the ultimate competitive advantage. With the company about to double its size with one acquisition, the right application delivery strategy was needed to enable fast integration of new employees without increasing IT staff.

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DARELL ZERBE
Chief Information Officer
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> "The carping of [Amazon] investors illustrates why anyone who goes public these days should have their head examined."
>
> *–Frank Fortin*
> *Needham, Mass.*

BRICKBATS AND KUDOS FOR JEFF BEZOS

AMAZON'S DETOUR into sharing infrastructure as a paid service is not surprising ("Jeff Bezos' risky bet," Cover Story, Nov. 13). Bezos is a high-energy creator, not a grind-it-out operations executive.

Amazon.com Inc. may have some valuable assets and intellectual capital, but I doubt this is a good new business venture. There are still too many open issues for it to work, and it is not the time for such a costly diversion.

This might be a signal that it is time for Bezos to step aside, be the chairman, and bring in an experienced operations-oriented CEO. Amazon and its shareholders would benefit.

–Ed Holden
Naples, Fla.

THE CARPING OF [Amazon] investors illustrates why anyone who goes public these days should have their head examined. Complaining about Amazon's heavy investing in technology for the sake of another percentage point in margin borders on criminal insanity. These people aren't investors, they're vultures. If they don't like the stock's price-earnings ratio, they should sell their shar

–Frank F
Needham, M

SARBOX: MORE PAPERWORK BUT FEW PROSECUTIONS

THE BENEFITS THAT Annette L. N reth ascribes to current Sarbanes-O regulations are way off the mark ("K ing SarbOx is crucial," Outside S Nov. 13).

Nazareth suggests that minor tw and incrementalism will erase the n tive effects SarbOx has had over the four years. What's really needed is the opposite: bold, decisive actio achieve the overarching goal of pro ing shareholders' interests without c ing massive and ongoing deteriorati shareholder value.

If SarbOx has been beneficial to co rations of all sizes, why is there so m furor focused on the disproportio costs of Section 404 and the overzea "one size fits all" approach? [Sec 404 requires companies to test cont assuring accuracy of publicly repo financial information.] The reality is Section 404 has caused a massive nomic disruption. While it is true

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POUR HOMME

ect costs have decreased somewhat, y have not dropped nearly as far as ected or desired. Most companies l have to cope with high indirect costs; lit fees are at an all-time high; and ounting firms are reporting record fits.

Not attributing the decrease in initial lic offerings in the U.S. even partially Section 404 is unrealistic. Other coun-s, including Britain and Canada, are plementing stronger internal control icies, but they are nowhere near as trictive or costly.

The Securities & Exchange Commis-n and the Public Company Accounting ersight Board will have an opportunity fix an unprecedented series of wrong ns and put SarbOx regulation back track when they release new manage-nt assessment guidance and auditing idelines on Dec. 13.

If America's global competitiveness d position as the world's preeminent ital market is to be maintained, eeping changes must be made to the rrent SarbOx regulatory regime.

–Paul A. Sharman, ACMA
President and CEO
Institute of Management Accountants
Montvale, N.J.

MAJOR PROBLEM with Sarbanes-ley is that there haven't been any minal prosecutions in the four years ce its enactment.

SarbOx promised the public that of-ders could get jail sentences up to 20 ars and fines up to $5 million. With re than 1,200 financial restatements 2005, one would think that some ecutives would be prosecuted. Where the U.S. attorneys and the SEC En-rcement Div. when the investing public lly needs them?

–Carl Olson
Chairman
Fund for Stockowners Rights
Woodland Hills, Calif.

DOESN'T HAVE TO BE HE END OF THE LINE FOR COAL

O MUCH DEPENDENCE on any one chnology or source is not prudent plan-ng ("Coal: Could be the end of the e," Environment, Nov. 13).

While biofuels such as ethanol and llulosic ethanol and renewables such wind or solar power are part of the lution, you cannot ignore the U.S.'s 0-year coal supply. Close to 50% of this untry's electricity is produced from al. We could be on our way to energy dependence if we could figure out environmentally friendly ways to harness our core natural advantages—an abundant coal supply and the opportunity to extract oil from unconventional resources, such as tar sands.

Clean coal technologies are worthy of investment. Renewables are good ways to achieve some portfolio diversification. However, we cannot currently store the electricity produced from sun or wind to use at other times on a large scale. This is why most renewable resources do not work without a backup power supply.

Renewables also lack the ability to be turned on or off or to adjust to rising and falling energy needs in the same way a coal plant can. We should give credit to coal where credit is due.

–Chuck Chakravarthy
Partner, Energy Strategy Practice
Accenture
Fremont, Calif.

MAYBE UNIVERSITIES SHOULDN'T RUSH TO BEEF UP BIOTECH

BEFORE UNIVERSITIES invest heavily in updating their biotech curriculums to satisfy the demands of industry recruiters ("Biotech's beef," Science & Technology, Nov. 6), administrators should insist on continued long-term job guarantees for its graduates, including the payoff of costly student loans.

In the late '80s and early '90s, educational institutions invested in expensive upgrades of their information technology departments and programs. Just as these updated programs began producing graduates, the rug was pulled out from under students by uncontrolled outsourcing and granting of H-1B and L-1 visas. As a result, enrollment in information technology programs has declined by about 20%.

It's time for Microsoft Corp. to stop bellyaching about the insufficient number of information technology graduates and acknowledge the damage that visas and offshore outsourcing are doing to our institutions of higher education.

–Louis A. Carliner
Masaryktown, Fla.

DON'T FIRE PRODUCTIVE WORKERS WHO NEED HELP—COACH THEM

THE WELCHES MADE an important point ("Send the jerks packing," The Welch Way, Nov. 13): No one wants to work with a person who is out of step with company values. These people are extraordinarily damaging. However, labeling them jerks eschews the value of talent development. Firing inappropriate workers when they are top producers is not smart, and it may even be counterproductive.

The cycle of firing, hiring, orientation, and training as a policy is risky and expensive. New hires are the devils we don't know. Difficult yet valuable managers can often be brought along with less expense and with significant return on investment. Professional coaching designed to focus on the developmental tasks of executive growth, with a commitment to align with corporate values, has been shown to produce effective, lasting change. Humanizing the workplace through coaching is consistent with a growing American workforce.

–Rabbi Richard A. Davis
New York

IF ILLEGALS COULD TRAVEL FREELY, MORE MIGHT HEAD HOME

"WHO'S AFRAID OF Charlie Rangel?" (News & Insights, Nov. 13) again raises the prospect of an immigration deal now that the Democrats control Congress.

As a conservative, I support a guest worker program, and I believe the reason we have so many illegal immigrants in the U.S. is because they cannot risk leaving for fear of not being able to return for work. I believe that if these workers were allowed to travel freely with a guest worker card, many would return home. I've not yet heard a reason why we should provide them with a path to citizenship.

I think President Bush would have a better chance of success if he took the citizenship offer off the table and focused strictly on a guest worker program. Business needs labor, but it doesn't care whether that labor has U.S. citizenship.

–Eric Dalton
Little Rock

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Tech&You

BY STEPHEN H. WILDSTROM

PlayStation 3: It's Got Game

Sony took a huge gamble in designing the PlayStation 3 around two untested technologies, the Cell processor and Blu-ray disc storage. The price it paid was long delays in getting the product to market. It will be months before we can tell whether PS3 is a winning business proposition, but technically the results are impressive.

If you or someone on your holiday gift list is counting on seeing a PS3 this year, you probably should forget it. The very limited supply of consoles sold out as soon as they became available on Nov. 17, despite lofty price tags of $500 or $600 (the extra $100 triples hard-drive storage, to 60 gigabytes, and adds wireless networking).

The PS3's appeal hits you right out of the box. It has a curved, shiny black case with no external power brick, and it makes Microsoft's Xbox 360 console look positively pedestrian. Another big difference is obvious as soon as you turn it on: The PS3 whispers, while the Xbox's cooling fan emits an ill-mannered roar.

The heart of the PS3 is the Cell Broadband Engine, developed jointly by Sony, Toshiba, and IBM. It crams nine processors onto a single chip barely a half-inch square. Designed for low-power consumption and primed for computationally intense chores such as high-resolution graphics, the Cell chip will eventually be used for many tasks other than games. IBM is building a supercomputer for the Los Alamos National Laboratory using more than 16,000 Cells.

BLU-RAY HAS BEEN SONY'S ACHILLES' HEEL because it drove the cost of the PS3 up, and a severe shortage of the drives cut the production planned for this year by more than half. But there are two reasons why Sony bet so heavily on it. It can store up to 50 GB, more than five times the capacity of Xbox 360's DVDs. That means game designers can create games with the vast amounts of data required to realistically simulate smoke and water and surfaces that do not break up into pixels, no matter how close you get to them. And the sale of millions of PS3s would give the Sony format a big leg up over the rival HD-DVD format for high-definition movies.

I'm not much of a gamer, and about all I could do in the short time I had with the PS3 was to learn how the controls worked in such games as *Resistance: Fall of Man*, *Tiger Woods PGA Tour 07*, *NBA '07*, and *Genji: Days of the Blade*. But I can say the graphic details and effects on a high-def display were by far the best I've seen on a game console, and the play was brisk and smooth.

I was much less impressed with the PS3 as a home entertainment device. It has great potential, looking and sounding like it belongs in a home entertainment system, but Sony has done little to bring it all to life. Its strong point is the ability to play Blu-ray movies as well as conventional DVDs, though there are only abo 100 Blu-ray titles available.

The PS3 does next to nothing with its netwo connection. It has a Web browser, but it's really only useful for visiting Sony's online store to purchase accessories and game add-ons, and to download demos. Unlike the Xbox 360, the player cannot play music or show photos stored on the network; to do that, you must first copy the conten to a memory card or external hard drive and then transfer it to the PS3. I can only hope that Sony will fix these obvious deficiencies.

PS3 is a gamer's dream, but it disappoints as a home entertainment device

In the end, however, most people are going to consider th PS3 primarily as a game conso and the question for them is whether it is worth at least $10 more than an Xbox 360 and more than twice as much as the new Nintendo Wii, which i basically an updated GameCul

Here's my answer: The PS3 is clearly the most capable hardware around. It's a bit short on games at launch, but th should change quickly, and it can run most of the hundreds of PlayStation 2 games out there, though some compatibili issues have surfaced. Sony's online game offerings are no match for the $50-a-year Xbox Live, but they are free and should grow. If you have the budget, the PS3 is a winner. ■

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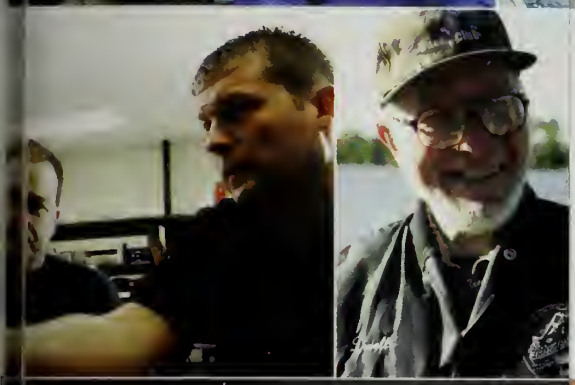

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MediaCentric
BY JON FINE

London's New Media Lessons

I love newspapers, despite everything I've written about them, and this is what brought me to the London offices of *The Guardian*. I wanted to see how a serious newspaper is grappling, in new and interesting ways, with the medium's litany of ills. ¶ London is still newspaper-centric in ways difficult for Yanks to grasp—10(!) national dailies are published there—bu

competition has crushed bottom lines. "In the next three years it will be very tough for any newspaper to be profitable," says Carolyn McCall, chief executive of Guardian Media Group. She adds that losses last year at *The Guardian* and its Sunday paper, *The Observer*, excluding costs related to new presses, topped $35 million.

In the U.S., where it's bad if major dailies' profit margins fall to single digits, McCall's comments would provoke aneurysms. But *The Guardian* has plenty of company among Britain's "quality" newspapers (as opposed to its "popular" ones, the classic tabloids). News Corp.'s Times Newspapers Ltd., parent of the *Times* and *Sunday Times*, lost around $90 million in 2005, according to the *Times* itself. Total *Financial Times* losses in 2003 and 2004 neared $80 million. The challenges are familiar: Younger audiences turn away; free newspapers provide significant competition; Web sites win eyeballs and ad dollars. A study by ad giant GroupM says the Web's share of British ad spending this year will top 13%, roughly double its share in the U.S.

RUSBRIDGER His paper's opinion site helps keep readers in the fold

ONE KEY *GUARDIAN* RESPONSE is novel: If readers want to gather and chatter, let them, even if there's no obvious way to make a pound off those conversations yet. "Readers are nearly as interested in talking to each other and publishing themselves" as they are in what a paper produces, says *Guardian* editor Alan Rusbridger. "You have to host that space" lest your readers simply flee.

To date, *The Guardian* has launched three sites that lean heavily on what's clunkily termed "user-generated content." One covers travel, another the arts. The earliest and best template of such efforts, though, is its Comment is Free opinion site. It appears onscreen as a riot of author names and links. (Picture a less cluttered, more text-heavy version of U blog site HuffingtonPost.com.) On Comment Is Free, *Guar ian* columnists appear on equal footing with Central Amer can poets and local bloggers. In other words, *The Guardian* has opened its doors to outsiders and done away with the privileged position that news papers accord their writers. T front page also includes prom nent navigational tools alertin readers to the most active de- bates and the best stories fou elsewhere on the Web.

A free-for-all opinion site c not come without complicati One, Rusbridger admits, is ra comments. Another, McCall says, is that users don't take s changes lightly: "They think theirs." She admits it's not ye clear how to make money fro Comment Is Free's back and forth, though she expects ads to appear eventually.

This point does not worry some savvy American media executives, who've long applauded *The Guardian* for its online moves. "*The Guardian* has, in my view, been way ahead" of U.S. newspapers, says Jim Kennedy, vice-presid and director of strategic planning for the Associated Press "It's about creating a new environment for your audience come in and stay." (Gannett's early November announcen that it will restructure its newsrooms, in part to bring in more user-generated work, is intriguing but nascent.) The is some irony that a British newspaper is beating America in adapting to technology. Back in the late 1960s, one of the things that most impressed Led Zeppelin's Jimmy Pag about America was that the telephones worked. These day though, Britain is the more thoroughly broadbanded nati And I suspect American newspapers will accept ideas fro wherever they can find them. ■

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E JAMES C. COOPER

The Housing Grinch Won't Steal Christmas

allets are open, and even the outlook for home sales is improving

U.S. ECONOMY 'Tis the season—for retailers, that is. It's make-or-eak time, and it all starts on Black Friday. That's what the industry lls the day after Thanksgiving, when the initial surge in holiday ying puts everyone's bottom line "in the black." Store receipts over e next few weeks typically account for about 20% of retailers'

ual sales and an even greater percentage of the r's profits. The question is, will consumers fork over money? That's a special concern this year, given the ries that the housing slump might cut into the action. etailers can put their fears behind them—and that's d news for the overall economy this quarter and next. sumers are heading into the holidays buoyed by the diest set of spending fundamentals in years. The r markets are strong, with the unemployment rate 5½-year low of 4.4%. Gasoline prices are down 26% e early August, resulting in a windfall of purchasing ver for household incomes. Stock prices, based on the ndard & Poor's 500-stock index, are up 13% since July, l confidence measures are generally upbeat.

here is still almost no evidence of spillover effects n the housing downturn on consumer buying. That ans the slump remains confined to the housing tor. Sharply lower home construction is a big drag on nomic growth, but consumers are providing a crucial et. Although some signs indicate housing demand is oilizing, builders are still getting hammered, as seen he steep 14.6% drop in housing starts from September October, to the lowest level in more than six years. That plunge in starts assures there will be another able hit to overall growth this quarter from cutbacks esidential construction. In the third quarter, nebuilding subtracted more than a full percentage nt from the growth in real gross domestic product, l this quarter's bite will be just as big. However, based the latest readings on retail sales and consumer prices ough October, consumer spending in the fourth arter is speeding up.

CENT GOVERNMENT REPORTS on retail sales uire a careful reading. October sales dropped 0.8% m September, when they fell 0.2% from August. Those lines mainly reflected back-to-back decreases in gas tion receipts of 11.1% and 6%, indicating lower pump ces, not less gasoline buying.

In addition, retail sales of building materials and plies fell for the third consecutive month. For rposes of measuring GDP growth, though, the government counts that activity as part of residential construction, not consumer spending. Overall retail sales from July to October fell at a 4% annual rate, but sales excluding gas and building materials grew at a healthy 5.1% rate. The bottom line is that consumer spending on most items began the final quarter with a head of steam, fueled largely by the additional buying power fueled by falling energy prices.

THAT BOOST WAS EVIDENT from the overall consumer price index in September and October. It posted monthly declines of 0.5% in each month, the largest two-month drop since 1948. The fourth-quarter CPI will actually be below the level for the previous quarter, a rare event in the past half century.

That means the same paycheck this quarter will buy more goods and services than it did last quarter. For example, the Labor Dept. reported that real weekly earnings of production workers in October increased 1.3% from September, when they rose 1% from August. Those were the biggest back-to-back gains in 24 years (chart).

CHEAPER ENERGY MAKES PAY STRETCH FURTHER

Data: Labor Dept., Global Insight Inc.

Consumer momentum is the chief reason retailers shouldn't fret about the housing slump spoiling their holiday party. Clearly, some of the housing-related data of late have looked alarming, especially the surprisingly large drop in October housing starts. But that decline might have been an exaggeration. The huge 26.4% plunge in new home starts in the South was one of the largest on record for that region. Several analysts say the swoon might have been due to exceptionally wet weather in that region. If so, the weakness may well reverse in November.

Right now, it is important to separate the demand-side reports from those on the supply side. Several sales

indicators appear to be stabilizing even as builders work through their stocks of unsold homes by cutting new construction and prices. Construction cutbacks will most likely continue through the winter, but the apparent bottoming out on the demand side is an important barometer of the eventual turnaround in new building.

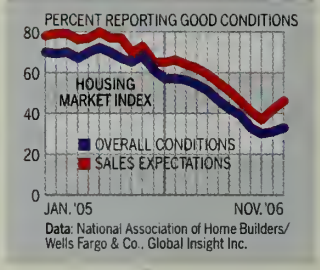
Strengthening demand is particularly noticeable in the new-home market, where sales increased in both August and September, the first two-month rise in a year and a half. Lower mortgage rates and the increasing willingness of sellers to drop their prices are a big part of the story. Rates for 30-year fixed mortgages have declined from a national average of 6.86% in June to 6.15% on Nov. 10.

THE MOST FAVORABLE SIGN that demand for homes will continue to firm comes from weekly mortgage applications to buy a house. Not only have applications stopped falling, their three-month average is now rising after declining steeply for more than a year. The applications statistics foreshadow data on housing sales, and sales are what drive new building.

Even builders are starting to see some movement on the part of buyers. After hitting a 15-year low in September, the index of housing market conditions, based on a survey by the National Association of Home Builders, edged up in both October and November (chart). The NAHB surveys builders on current sales, expected demand, and buyer traffic through model homes. Their November report on current sales edged up slightly, but sales expectations rose significantly, and they noted increased traffic of prospective buyers.

While builders work through their problems, the economy is also getting plenty of support from businesses expanding their operations. Look at the risi trend of orders for capital goods and the recent increas in industrial production of business equipment.

BUILDERS' SENTIMENT: BOTTOMING OUT?



Data: National Association of Home Builders/ Wells Fargo & Co., Global Insight Inc.

Factory output, down 0.2% for the second month in a row in October, has been faltering under the weight of cutbacks in t auto industry and fallin demand for constructio supplies. Yet monthly production of business equipment posted a strong gain, as did outp of high-tech equipment such as computers and peripheral equipment, telecom gear, and semiconducto Production of aerospace equipment was also strong. Capital spending and outlays for business construction will be other key areas of support for the economy this quarter and next.

On balance, the holiday season is shaping up nicely for the economy. With gift cards selling at a brisk pace, retailers should be merry well into the new year as reven from the gift-card business show up in January. The only place to look for the Grinch is in housing, but even there, scattered signs offer hope for better times in 2007. ■

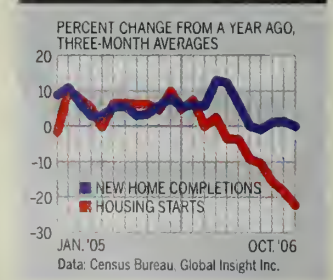
HOME PRICES

A Good Time to Ask Santa for a New House

LOWER HOME PRICES, which are boosting affordability, are a big reason why new-home demand is stabilizing. And it looks like prices in several markets will be heading even lower in coming months. Although construction activity is dropping sharply, a lot of new homes are still coming to market and builders' inventory levels remain uncomfortably high.

While housing starts in the three months through October have plunged 22.2% from a year ago, new-home completions are off only 0.1% (chart). That means, despite the construction cutbacks, the rate at which new homes are up for sale hasn't fallen by much. In fact, completions were up 4.5% from a year ago in the Northeast and off just 3.9% in the West, two areas where the housing boom was the strongest and where prices are already cooling quickly.

A MIX THAT SUGGESTS MORE PRICE DECLINES

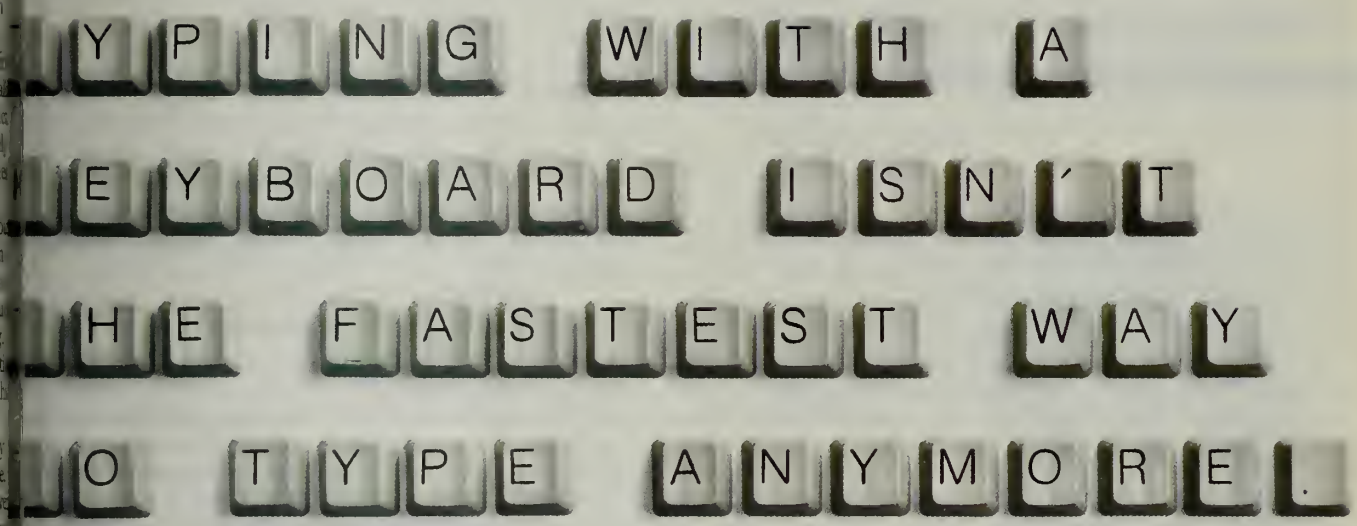


Data: Census Bureau, Global Insight Inc.

The slowdown in homebuilding traditionally follows a decline in new-home sales, but this time the lag has helped push up the homeowner vacancy rate to a record level of 2.5% in the third quarter. And the stock of completed new homes that remain unsold as of September grew by 46% from a year ago. The elevated level of both new and existing homes for sale is already pressuring builders to reduce prices. The median price of a new home in September fell by 9.7% fro a year ago, the largest annual decli since 1970.

The good news for builders is t lower prices, along with a retreat in mortgage rates, is stemming the slide in new-home sales. The consensus expectation among economists is that October sales stood at an annual rate of 1.05 million, compared with 1.08 milli in September. Even so, "we still probably need more adjustment c the price side before the inventor overhang is reduced sharply," say Joel L. Naroff, president of econo consulting firm Naroff Economic Advisors. Some of that adjustmer says Naroff, will not show up in government data as builders thro in perks, such as an upscale kitch rather than cutting the list price.

–By James Mehring in New



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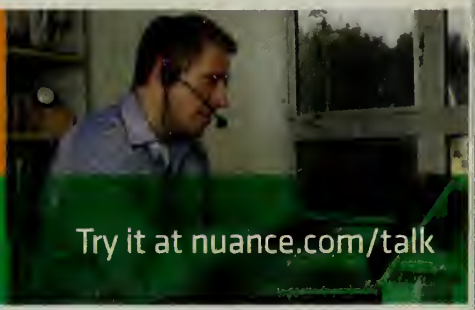

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News you need to know

EDITED BY HARRY MAURER

Deals, Deals, Deals In a chockablock week, private equity continued its rampage. On Nov. 19, **Blackstone Group** agreed to buy **Sam Zell's** commercial real estate unit, **Equity Office Properties Trust,** for $36 billion including debt. (Its properties include the Civic Opera House in Chicago, photo.) The price would erase the previous LBO record, the $33 billion ponied up for **HCA** last July. Meanwhile, a war was shaping up over another REIT, **Reckson Associates Realty,** for which **Carl Icahn** and **Macklowe Properties** bid $4.6 billion on Nov. 16, topping a previous bid of $4 billion.

Private equity also grabbed two battered media outfits. A group captained by **Thomas H. Lee Partners** and **Bain Capital** landed radio giant **Clear Channel Communications** for $26.7 billion, and a **Ripplewood**-led team said it would buy **Readers Digest** for $2.4 billion.

See "Did Sam Zell get the right price?" page 36,
ONLINE *plus "Sam Zell: A question of timing" and "End of the Clear Channel era," www.businessweek.com/go/tbw*

A Bid for a Bourse **Robert Greifeld,** the driven **NASDAQ** CEO who has zipped through four marathons, is pressing once again to run the **London Stock Exchange** to ground. On Nov. 20 he offered to buy the 71.25% of the LSE that he doesn't own in a deal that would value the exchange at $5.1 billion. After the **New York Stock Exchange** moved closer to snapping up **Euronext** when rival **Deutsche Börse** dropped out of the running on Nov. 15, Greifeld more than ever wants to "redefine global equity trading" by folding the Brits into NASDAQ, he told reporters. He also sees the London bourse, with its surging popularity for initial public offerings, as crucial. LSE leaders remain resistant, and NASDAQ may have to sweeten the price.

See "Up against the wall in the City," page 46

Schwab Unloads a Unit This unlikely marria never really worked. **Charles Schwab,** discount broker the masses, bought genteel private banker **U.S. Trust** f $2.7 billion in stock near the peak of the Internet sto bubble in January, 2000. The synergies Schwab predict didn't materialize, so now, **Bank of America** is payi Schwab $3.3 billion in cash for the unit. Schwab says will use the money for general purposes and to buy ba its stock, which trades around $19, vs. $25, split-adjuste at the time of the original deal. Bank of America will le to No. 1 among U.S. wealth managers.

Freeport Wants Phelps Mining outfits are so busy pr pecting for other miners that it's a wonder they get any mi ing done. The latest union: On Nov. 20, **Freeport-McMoR Copper & Gold** said it will buy **Phelps Dodge** for $25.9 billi creating the world's largest copper producer. At about $1 a share, the offer represents a shiny 33% premium for Phel Dodge but still may be a bargain for Freeport, analysts sai

ONLINE *See "Is Freeport McMoRan's offer enough*
www.businessweek.com/go/t

Yahoo! and the Dailies Newspaper publishers seem be thinking that maybe those online guys aren't so bad af all. On Nov. 20 seven U.S. chains that run 176 daily pap signed up with Internet portal Yahoo! to share content a advertising. **MediaNews Group, Hearst, E.W. Scripps,** and oth will start posting classified ads on Yahoo!'s **HotJobs** site a use its technology to run ads themselves online. The de which gives Yahoo! more presence in local markets, follo a recent move by rival **Google** to sell ads in 50 papers.

See "Newspapers' new online delivery boy," page
ONLINE *and "Yahoo's classified ad visio*
www.businessweek.com/go/t

Implants Get the Nod **Allergan,** which has been erasi wrinkles for years with its hit product **Botox,** now gets take a crack at another form of enhancement. On Nov. the **FDA** approved silicone breast implants, sending sha of Allergan up 6%. In 2005 the Irvine (Calif.) drugmal won a bidding war to acquire breast-implant maker **Inan** for $3.2 billion. Now that silicone is off the breast blackl the $350 million market for implants could double. All gan competitor **Mentor** saw its shares jump, too, by 13%.

Rupert Regrets Key properties of **Rupert Murdoch's N Corp.** got whacked twice in three days. First, his ultra-po lar social networking site **MySpace** was sued on Nov. 17 powerhouse **Universal Music** for allegedly creating a "v virtual warehouse" to pirate music from Universal a such as U2 and Mariah Carey. Then, under pressure fr critics and its own **Fox TV** affiliates, News Corp. said it v scrapping plans to air a two-hour show featuring acq ted murder suspect **O.J. Simpson's** account of how he mi have committed twin murders. Calling the project "ill-c ceived," Murdoch also said his **HarperCollins** unit woul publish Simpson's *If I Did It*. At least Murdoch can

ıshbuckle: In Britain, his 39%-controlled **BSkyB** satellite vice moved to block **Richard Branson's** plan to start a rival work by buying an 18% stake in **ITV,** Britain's largest adcaster. But even there, Murdoch could face an inquiry antitrust regulators.

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tions Watch It looks as if **Robert "Skip" Cummins** hit erve at medical-implant maker **Cyberonics.** The com- ive chairman and CEO quit along with another execu- e on Nov. 20 after a board committee uncovered years stock option grants that had been improperly dated. mmins, 52, faced down would-be acquirers and critics ce as he won regulatory approval for his main product: acemaker-like device used to treat epilepsy and depres- n by micro-zapping a central nerve in the neck. Among spurned: **Medtronic,** which offered to buy the Houston npany in 2000 at $26 a share. The stock closed at 4.63 on Nov. 21.

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mpest in a Dollhouse Ever since **Isaac Larian** brought the **Bratz** line of dolls five years ago, he has been locked a market-share catfight with **Mattel's Barbie.** The tarty, ndier Bratz have captured the eye and purses of girls ghtly older than those who favor Barbie. Mattel sued de- ner **Carter Bryant** in 2004, claiming he developed the Bratz ncept while working for the company. On Nov. 20, Mattel ended the suit to add Larian's company, **MGA Entertain- nt,** saying it stole key employees and secrets and used em to start Bratz. Larian pooh-poohed the suit, claiming t Mattel has "failed miserably at fair competition through oduct innovation." Mattel declined comment.

Obituary of the Week

ilton Friedman was equally an economist and a freedom ghter. Right up to his death at age 94 on Nov. 16, he vaged war against what he saw as excessive govern- nent. Friedman once said: "I am in favor of cutting axes under any circumstances and for any excuse, for ny reason, whenever it's possible." The Nobel prize vinner stuck to his libertarian principles even when hey unsettled the conservative Establishment. Cases in oint: He opposed the military draft nd favored legalization of drugs. eaching for decades at the Univer- ity of Chicago, Friedman challenged he legacy of **John Maynard Keynes,** he British economist who believed hat government should steer eco- nomic growth. **Paul Samuelson,** the nore liberal rival with whom he of- en battled, said in an interview with *BusinessWeek*: "Milton Friedman was giant....No 20th century economist had his importance n moving the American economic profession rightward rom 1940 to the present."

MILTON FRIEDMAN

ONLINE *See "Milton Friedman: Death of a giant," www.businessweek.com/go/tbw*

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DIRECT MARKETING

CATALOGS, CA

ALOGS, EVERYWHERE

Net shopping isn't rendering them obsolete. It's just changing their role. BY LOUISE LEE

FOR SMITH & HAWKEN, THE FUTURE lies in cyberspace. Sales of flower pots and gardening gadgets on the company's Web site are blossoming, accounting for 20% of total sales of $170 million in 2005. Meanwhile, catalog sales are wilting, declining to 15% of total sales last year, from 19% the year before.

So why not just ditch the paper catalog?

Not a chance, says Felix Carbullido, senior vice-president for marketing at the Novato (Calif.) outdoor-accessories seller. Rather than becoming obsolete in the online age, he says, the old-fashioned catalog is the most effective way to make an emotional appeal to the consumer. And ultimately, he argues, the catalog is the best method to convince customers to go online. "It's not just about commerce from the catalog," says Carbullido, who helped redesign Smith & Hawken's catalog earlier this year.

Thanks to e-commerce, as well as rising printing and mailing costs, catalogs were supposed to be dead by now. But a quick visit to the mailbox will confirm that predictions of their death have been vastly exaggerated. Catalogs are, in fact, more popular than ever—and thriving because of the limitations of shopping by pointing and clicking. Unlike the bulky books of yore, such as the venerable Sears catalog, which at times ran to 1,000 pages, the new breed of catalog is a glossy, magazine-like statement meant to convey to consumers the look and feel of a brand. That's a task the typical home PC just isn't up to, no matter how good the resolution of the monitor. The prototypical new catalogs don't attempt to list everything in the product line. Rather, they simply show a carefully selected and dramatically photographed selection. "We're promoting an entire lifestyle in the garden or patio, not just items," says Carbullido.

Sure, consumers may complain about the stacks of catalogs stuffing their mailboxes. But they're using them anyway, and their actions are speaking louder than their words to retailers. That's why the rate at which companies are sending out catalogs is on the rise. In 2005 the number mailed grew by 5.5%, to 19.2 billion, compared with a 5.3% growth rate the prior year and 3.8% in 2003, according to the trade group Direct Marketing Assn.

A big mass-mailer like Victoria's Secret ships 400 million of them annually, or 1.33 for every American citizen. What can Victoria's Secret possibly get out of those 400 million catalogs? Plenty. Last year its catalog and online orders accounted for nearly 28% of its

JOHN KUCZALA

overall revenues of $4.4 billion. Those sales grew by 10%, more than double the 4% increase from its stores. Catalogs have become so important to the retailer that it even lists the cost of mailing, paper, and printing as a "risk factor" in its financial statements because an increase in those expenses could hurt earnings. That's not the only potential trouble: The lingerie company has drawn fire in recent years from forest conservation groups.

Even companies that started life on the Web appreciate the allure of a well-designed catalog. Zappos.com, the online shoe giant, in the last few weeks started including its Zappos Life catalog with orders. At tiny candy company Johnand-Kiras.com, co-owner John Doyle started a catalog in October after operating for more than four years only on the Web. The e-commerce site itself is an efficient way to place an order, but "it's not a good way to attract attention, especially with new customers," says Doyle. Marketing through electronic mail, while cheap, often gets caught in spam filters, he says.

Now that catalogs have a new mission as brand-building devices, companies are making fundamental changes in their design. Because catalogs are meant to give consumers ideas instead of listing every item in the product line, marketers can make them smaller. Clothier Talbots Inc. has in recent years used small, square catalogs to promote holiday gifts and men's clothing. But last year it extended that strategy to its core women's apparel business, starting up an early fall catalog with fewer pages than its regular 8-in.-by-11-in., 80-page women's clothing books.

Meanwhile, online come-ons are sprinkled everywhere in today's catalogs. In the current L.L. Bean catalog for outdoor gear, page 3, a prominent spot in any catalog, features a blurb about a sales rep's climb up Mt. Everest.

Victoria's Secret will mail **400 million** catalogs in 2006

Data: Victoria's Secret

"Read about his trip and see his remarkable photographs" at the Bean Web site, it says. Indeed, almost every spread in the Williams-Sonoma catalog tells readers to go online for information ranging from sample Thanksgiving menus to recipes for Brussels sprouts.

Even as they try to drive people to the Web, companies are also working harder to tap into a desire of consumers to have something to touch and hold. "Catalogs are a tangible connection in an intangible, online, all-in-the-ether world," says Wendy Liebmann, president of WSL Strategic Retail. For instance, the cover of L.L. Bean's clothing catalog this season features an actual fabric swatch for its Fitness Fleece Pullovers. "Feel the softness and the quality," the cover copy says.

To fire shoppers' imagination, high-end retailers from Saks Fifth Avenue to Neiman Marcus are upping the number of over-the-top fantasy gifts they're offering. Lavish descriptions of these offerings, such as Neiman's $1.7 million rocket trip into space, are more than sales tools. They also make good reading material. "People like to receive a beautifully produced catalog. It's entertaining," says Tony Cox, a catalog consultant in Richardson, Tex.

Not all of the intellectual energy is going into design and story telling. Some companies ar trying a highly scientific tac to sharpen their catalogs, us ing complex mathematic methods allowing them t test and track many change simultaneously to save tim In 2004, Williams-Sonom shipped out 56 versions o its flagship Mother's Da catalog, each one just slightly diffe ent from the others. Some versions varie the number of products on the cutlery la out or included a letter from the compan founder, for example. Others included a index. Then, the company took sales da from each version and analyzed whic changes generated the best sales. Amon the findings: While most changes didn make much difference, four did, each b increasing sales in the catalogs by up t 7%. Among the tweaks that boosted pe formance: adding an index and includin a tear-out recipe card.

Some companies are pursuing top-to-bottom redesigns, a task Smith Hawken just completed. Previously, th typical layout in a Smith & Hawken cata log had as many as six items, each show in photos of roughly equal size. Lightin was stark. Copy focused heavily on th attributes of the products themselves. I the spread showing the Hadley Peak lin of wooden furniture, for instance, th main 5-in.-by-7-in. photo of the furnitu is on one page and surrounded by s photos of other products. The lightin in the main photo casts hard shadows chair legs onto a brick patio. Folded na kins and glasses on the table are unuse The spread, says company creative dire tor Sam Osher, "was item-specific. Th imagery was based just on the product.

Fast-forward a year to the new desig Using a practice known as "heroing," blowing up an item so it overshadow everything else in the layout, Smith Hawken now promotes the same Hadl Peak furniture using a 6-in.-by-11-i photo spread over the layout. It's su rounded by only three other items in f smaller photos, making the furnitu the clear focal point. The table is s with actual food and glasses of beer, or half-consumed to show that "there's li in there. Someone was using this na kin," says Osher.

Patio furniture that tugs at the hea strings? That's exactly the point. "We showcasing an environment to be asp rational, inspirational," Osher says. "V want to build a scene that makes you sa 'I want to be there.'" ■

Total Catalogs Sent Out

EAL ESTATE

BIG BRAWLS OVER MALLS

Vith land scarce, developers try to thwart ach other using lawsuits and politics

CARUSO Bruising battles to build malls—and a $100 million antitrust suit

E CHRISTOPHER PALMERI

REAL ESTATE MOGUL RICK Caruso seems to have created a perfect world. His office, complete with a marble-topped bar and a model of his yacht, sits above the Grove, an upsle shopping center he developed in Ls Angeles. From his balcony, Caruso c gaze at the statues modeled after his we and kids. He can watch the trolley, vich carries shoppers along the Grove's tsty, European-style streets. Come the hidays, Caruso even makes fake snow f over the piazza twice a night.

Beyond the Grove's polished trash cis and synchronized fountains, howe:r, life is less serene. Westfield Group, a Australia-based mall owner, spent $3 nlion this election season to persuade nidents of the Los Angeles suburb of Adia to vote in favor of two initiatives nsponsored that prevent Caruso from pting up billboards and charging for pking at a shopping center he has pposed in the city. Caruso, meanwhile, hpes to go to trial early next year in a $100 million antitrust suit he's filed against General Growth Properties, the nation's second-largest mall owner. Caruso alleges that the Chicago company tried to kill another of his projects in nearby Glendale by telling prospective tenants they wouldn't get space in General Growth malls if they leased with him. "It's just morally wrong," Caruso says. General Growth declined to comment.

THE DINOSAUR CARD

SHOPPING CENTER development has become a cutthroat business full of lawsuits, strong-arm tactics, and costly political campaigns. With land for new malls scarce, owners who have invested hundreds of millions of dollars in big regional centers are trying to thwart each other's projects, citing the effects on traffic, endangered species, and even, if they can find them, dinosaur bones. "It's interesting that environmental issues are being raised by developers rather than by the community," says Patricia M. Johnson, a principal at Outcalt & Johnson: Retail Strategists in Seattle. "People are paying more attention to their competition than their customer."

Suitable land is so hard to find that only six large regional malls are projected to open in the U.S. over the next two years, according to the International Council of Shopping Centers. Annual growth in shopping center development has slowed to under 2%, a fraction of what it was in the 1970s and '80s. At the same time, the industry has been consolidated into the hands of a few large corporations, many of them publicly traded real estate investment trusts committed to delivering earnings growth on Wall Street. The 10 largest shopping center owners control more than 1 billion square feet of retail space, one-sixth of the nation's total and nearly twice as much as they did in 1998, according to the trade publication *Retail Traffic*.

Changing shopping habits, meanwhile, put indoor malls at a disadvantage. People like fresh air and sunshine, and outdoor malls are able to mimic the experience of quaint Main Streets while featuring popular chain stores. Retailers prefer these centers too, because expenses are lower when they don't have to pay for the heating and cooling of common areas. New centers often end up vying head-to-head for tenants and shoppers with older regional malls.

Shopping center developers have battled each other in Dallas, Houston, St. Louis, and Richmond, Va. Nowhere has the fight been as bitter as in the Los Angeles suburb of Glendale, which in 2001 chose to negotiate with Caruso to develop a 15-acre parcel of land. General Growth, which bought the nearby Glendale Galleria the following year, filed hundreds of comments on Caruso's plan, according to Gillian van Muyden, a senior assistant attorney for the city. It also submitted its own proposal. After the city gave final approval to Caruso in April, 2004, General Growth gathered enough signatures for a special election to challenge Caruso's award. The people also chose Caruso's plan, so General Growth sued the city, claiming its five-volume environmental report was inadequate and its selection process flawed. That case was decided in the city's favor in trial and appeals court, and the center is set to open in 2008.

General Growth also tried to kill proposed new shopping centers in Connecticut and Texas, according to lawsuits involving the company. E-mails filed in the Connecticut case show General Growth employees scheming to derail a competing mall by trying to "find a group of dinosaur lovers that feel there are bones or remains on the site." In both cases, however, the suits were settled and the shopping centers built. ■

HIGHER AND HIGHER The deal makes Blackstone the nation's biggest office landlord by far

REAL ESTATE

DID SAM ZELL GET THE RIGHT PRICE?

Blackstone's buyout of his Office Equity REIT looks like a bargain. Zell begs to differ

BY MICHAEL ARNDT

SAMUEL ZELL GOT RICH by snapping up assets everyone else had written off for dead. But the founder and chairman of Equity Office Properties Trust has blundered, too. Just as the dot-com bubble was bursting in early 2001, Zell engineered a $7.1 billion takeover of another real estate investment trust, Spieker Properties Inc., whose offices were in San Francisco and San Jose. Equity Office's share price would not recover for four years.

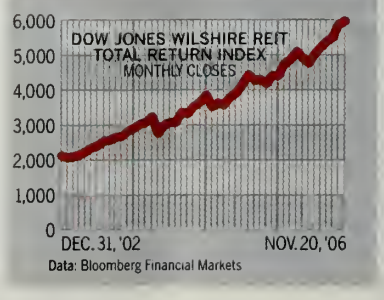
So when the Chicago-based company announced on Nov. 19 that it was selling itself to New York's Blackstone Group for $36 billion, including debt, in the biggest leveraged buyout ever, investors began wondering which Sam Zell was doing the dealmaking—the visionary or the myope.

To many, it sure doesn't look like the visionary. Cohen & Steers, which is Equity Office's largest shareholder with an 8% stake, figures the company is worth more than $60 a share, says James S. Corl, its chief investment officer. Instead, Blackstone is paying $48.50, just 8.5% above Equity Office's Nov. 17 closing price of $44.72. "It looks like the deal went on the cheap," agrees analyst Jonathan Litt of Citigroup.

Zell dismisses his critics. While Equity Office received "flirtations" from others, Blackstone's unsolicited offer was the only one that was fully financed. Zell also notes that the price was 20.5% above the company's three-month average share price. "It really doesn't matter what I do. There will always be someone who criticizes me," the billionaire says. "So be it."

Blackstone didn't vault to the top of the private-equity business by overpaying, of course. Most commercial real estate analysts are predicting rising rents and tighter vacancy rates in the near future as white-collar job growth outpaces office construction.

HOT PROPERTIES



Data: Bloomberg Financial Markets

What's more, investor dema for commercial property is gro ing as pension funds and otl institutions look for holdings tl pay better returns than gove ment bonds but aren't as volat as stocks.

The deal turns Blackstone i far and away the nation's bigg office landlord. Six weeks earlier partnership with Toronto's Bro field Properties Corp., Blacksto concluded a $7.2 billion takeo of Trizec Properties Inc., with fice towers in New York and ot big markets. That deal came af Blackstone paid $5.6 billion in July CarrAmerica Realty Corp., which is big Washington, D.C., and San Francisco. A in Equity Office's 109 million square f in 580 buildings, and Blackstone and affiliates would own some 160 million ft. of office space in the nation's big m kets. That's more than downtown Phoe Pittsburgh, and St. Louis have combine

For now, the office market shows sign of letting up. Developers have be notably slow to add space in most ma markets since the 2001 recession, desp interest rates that have hovered at h toric lows. Slim inventories have allow landlords to push up rents this year. E uity Office, for instance, says its vacar rates have dropped to 9% on average a should fall to as low as 6% by the end 2007. Meantime, average rent for its n tenants is up 13% from a year ago.

And investors, looking back on t outsize gains from REITs over the p five years, are clamoring to buy proper "Real estate has become the fourth cl of investment along with cash, stoc and bonds," says Glenn R. Muell a real estate specialist with Divide Capital Group in Denver. "It's seen a safe haven. It can't evaporate li an Internet stock; i still bricks and mor and land."

Zell continues to b lieve in real assets, t He remains chairm of Equity Residenti which owns 616 apa ment buildings in states and is the la est player in the la Don't expect the 6 year-old billionaire retire just yet. ■

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MERGERS AND ACQUISITIONS

WHAT'S BEHIND THE BUYOUT BINGE

With stocks cheap and private equity firms flush, this boom may be a record-breaker

BY EMILY THORNTON

THE MERGERS-AND-acquisitions boom is nearing uncharted territory. On Nov. 19 and 20, companies and buyout firms announced 40 deals worth $76 billion. Now many bankers are predicting that, just as the Dow Jones industrial average recently punched through its record level set in 2000, M&A, too, will eclipse its 2000 record. Already, $3.2 trillion of deals have been announced this year, vs. $3.4 trillion in 2000, according to Thomson Financial Corp. "We've basically grown into the merger marketplace that we saw in 1999 or 2000," says Paul J. Taubman, global head of M&A at Morgan Stanley. "We expect to see further highs in deal activity for some time to come."

But what's driving this year's merger mania is quite different from what prompted AOL to plop down $182 billion for Time Warner Inc. in 2000. That boom was fueled by inflated stock prices in an overheated equities market that made companies feel like they were playing with funny money. This time the drivers are low interest rates, low valuations, and robust debt markets. One telling difference: 60% of this year's deals have been paid for in cash, vs. 29% in 2000, estimates Thomson.

The biggest change, though, is the unprecedented heft of private equity firms. Morgan Stanley estimates that buyout shops are now armed with at least $2 trillion in purchasing power, far more than ever before. The number of public-to-private deals in 2006 is set to nearly double the number in 2000, to 205, while their value has soared more than tenfold, says Taubman.

Yet there's still plenty of room for the boom to continue. Many companies still look cheap. Those that make up the Standard & Poor's 500-stock index are trading at only 17 times their earnings, vs. 26.4 times in 2000. What's more, acquirers are paying smaller premiums than they did six years ago. That means they can probably afford to pony up for prime targets in their sights. In 2000, buyers of companies worth $10 billion or more paid an average premium of 30% above where companies' stock prices were trading the day before their deal was announced, according to Thomso Buyers nowadays are shelling out 25 more.

For now, no one is predicting th there will be any starry-eyed megamer ers, à la AOL-Time Warner. "Manag ments and boards are tough-minded t day about what assets are worth," sa Jack Levy, co-chair of global mergers an acquisitions at Goldman, Sachs & C Instead, look for more tactical deals th expand companies' existing businesse says Paul G. Parker, head of M&A in th U.S. for Lehman Brothers Inc. Alread the number of deals in excess of $10 bi lion is about the same as it was in 200 according to Thomson.

Changing political winds should als send mergers sailing forward. A Dem ocrat-led Congress might spark clos scrutinizing of potential megamerge on antitrust concerns. But that woul just open the door for private-equit firms looking to expand their portfolio "It always used to be that if a large corpo ration wanted to buy a company, it woul prevail over a private-equity firm," sa Parker, in part because companies coul afford to pay higher price tags than bu out shops. No more. ■

Merger Monday

A flurry of major deals and hostile bids were announced Nov. 19 and 20

ACQUIRER				
BLACKSTONE GROUP	FREEPORT-McMORAN COPPER & GOLD	NASDAQ STOCK MARKET	BANK OF AMERICA	TORONTO-DOMINION BANK
TARGET				
EQUITY OFFICE PROPERTIES TRUST	PHELPS DODGE	LONDON STOCK EXCHANGE	U.S. TRUST	TD BANKNORTH
PRICE				
$32.5 BILLION	$22.8 BILLION	$4.5 BILLION	$3.3 BILLION	$3.2 BILLION
PREMIUM*				
8%	34%	2%	NA	7%
RATIONALE				
Expands Blackstone's real estate empire	Creates the world's largest publicly traded copper company	Nasdaq tries to become international	Bank boosts its wealth management business	Takes U.S. banking business private

* Compared with companies' stock prices one day before deals were announced

Data: Thomson Financial Corp

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SIEMENS

SIMMONS The musician likes his Ning page because "it's my own"

WIRED LIFE

THERE'S NOT ENOUGH 'ME' IN MYSPACE

A raft of new services let users create their own personalized online circles

BY ROBERT D. HOF

LIKE MANY ASPIRING MUSIcians looking to get attention, Derek Simmons has a page on MySpace.com and posts his music videos on YouTube. But lately the main online home for his part-time hip-hop passion is his own personal social-networking site. He created it using Ning, a service co-founded by former Netscape Communications Corp. whiz kid Marc Andreessen that gives people more control over the look of their site and the way they share photos, videos, and other material. "I can dress it up so it's my own," says Simmons, a 43-year-old state worker in Orange, N.J., whose Ning site has gotten 12,000 views since he put it up two weeks ago. "It's a-l-l-l-l me."

Move over, MySpace. Just as the big online social networks are branching out, trying to reach an audience broader than teens and Gen Y, a raft of upstarts hopes to reach these same prospects. To attract older or less tech-savvy folks, they're offering ever-more-targeted services that can be personalized to people's existing social groups and interests. "We're empowering anybody to create brand personal social networks," says N Chief Executive Gina Bianchini.

FOLLOWING THE HERD

IT'S THE DAWNING of online so networking's cable-television era. St ing in the late 1970s, the spread of ca channels such as Home Box Office, Ni elodeon, and MTV started to slice a dice TV programming up into niches tractive to viewers and advertisers. N there's a similar explosion of niche cial-networking sites. They range fr karaoke and photography communi on Multiply to canine sites on Dog and community TV-style personal vi sites and mothers' groups created us do-it-yourself services such as Ning a PeopleAggregator.

The big question is whether th sites, which depend largely on adv tising for revenues, can overcome awesome momentum of such lead as News Corp.'s MySpace, with million users and 8 million more e month, and Facebook, with 12 mill people. If most of your friends are ready flocking to those sites, you do have much choice but to follow ther you want to participate.

The new services are aimed at tir starved people more interested in enri ing existing relationships and intere than finding loads of new friends. Ka erine Sukel belongs to MySpace beca the U.S. military wives' group in Gerr ny, where her husband is stationed, ha page. But, she adds, "I hate it. Nothir private." So for everything else, such sharing baby photos with friends a relatives, she has her own personal r work page on Multiply.com, which checks three or four times a day.

The incumbents aren't standing s though. Facebook is branching from its college roots to business a regional groups. "There is always opportunity for niche markets," s Melanie Deitch, Facebook's directo marketing. "But people are savvy, a they're going to stick to those that doing it well." ■

Do-It-Yourself Social Networks

Here are some of the upstarts that are targeting people who want more control over their online relationships:

NING
Backed by Netscape co-founder Marc Andreessen, it offers customized, do-it-yourself social Web sites

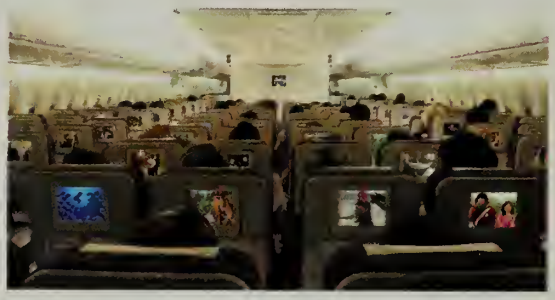
VOX
This new service targets older folks who want to share photos, videos, and blog posts with friends or family

ESNIPS
Lets people create individual "microportals" to share media related to such esoteric interests as African poets

DOGSTER
Ultra-niche site has 3,500 active communities for dog owners, attracting a hos of advertisers

www.koreanair.com

Entertainment



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COMMENTARY

BY ROBEN FARZAD

If Google Shopped Until It Dropped

What its $155 billion market cap could buy in a post-Thanksgiving binge

IT WAS A GLORIOUS Thanksgiving for the founders of Google Inc., whose shares now trade around $500, having more than quintupled in 27 months. Yes, a market value of $155 billion is some kind of cornucopia. So with tryptophan coursing through their veins and visions of search algorithms dancing in their heads, Sergey Brin and Larry Page let their post-meal thoughts drift to what most other Americans were fixating on: shopping.

If they didn't, they should have. The market has handed Google a pile of paper money that may or may not hold its value. Just ask rival Yahoo! Inc. At its peak, it was worth $150 billion; now it's worth $37 billion and kicking itself for not having spent more of its stash.

Google's surging stock is practically begging to be used for acquisitions. The company trades at 37 times next year's expected earnings per share, more than twice the broader market's price-earnings ratio. Analyst Laura Martin of Soleil-Media Metrics notes that to justify its valuation, Google would have to deliver 25% annual compounded growth over the next decade. Can its killer search engine pull off that kind of streak? It's doubtful. "At some point, they'll have diminishing returns from paid search," says Martin P. Pyykkonen, senior Internet analyst at San Francisco investment bank Global Crown Capital. "There's no question they need to diversify." The $1.6 billion acquisition of Internet upstart YouTube Inc. was a start, but much more can be done.

Portfolio strategists say investors can allocate as much as 5% of their portfolios to purely speculative holdings, also known as mad money. But with the stakes so big, Google would be wise to put aside even more of its paper value—say, 7% or 8%—for investments to add some real diversification. Herewith: a $12 billion holiday shopping list.

It should start with a contrarian media play: the New Yo Times Co., now worth just $3.5 billion, roughly its 1998 lev The industry has never been so uncertain, and Google h already struck deals with some newspapers to post archiv content. Meanwhile, Times management is under fire fro a big shareholder, Morgan Stanley Investment Manageme which is trying to change its governance structure to take so power away from the controlling Sulzberger family. What b ter time for a white knight to step in?

The asking price, including the assumption of debt and the tiation of the Sulzbergers, might be $6.5 billion. That would la Google the Web site About.com, 155 years of searchable *Tim* archives, and swank new headquarters in Times Square—all just 1/25 of the Google pie. I acts now, Maureen Dowd mig even emcee its holiday bash.

Next stop: real estate, which Google has too litt Any self-respecting media gia needs a theme park. For a p dling $2 billion or so, Goo could buy Walt Disney's agi Epcot Center in Orlando a rechristen it Google World. T prospect of animatronic Lar and Sergeys might not get n lions of tourists flooding in, b Google could actually use so losses to ease its tax load.

Commodities, baby! Goo is light in natural resource ho ings. Peruvian copper would two birds with one stone by p viding emerging markets exp sure as well. The problem is t pollution-spewing Peruvian copper mines kill thousands birds each year. Google's Prius-loving staff won't go for tha

So why not invest in Pacific Ethanol Inc.? It can be had an easy $1 billion, assuming a more than 20% premium. sides improving the planet, ethanol would give Google reas to pursue another complementary asset: Ted Turner, Americ largest individual landowner, with 2 million acres across sev states. Google's ethanol plants would need vast tracts of la on which to grow corn and switch grass—and Ted's 40,0 head of bison could happily fertilize that acreage. Price t Totally affordable.

That leaves emerging markets. How about assuming balance of Turner's $1 billion philanthropic tab to the U. Don't dawdle, guys. Use it or lose it. ■

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GERMANY

POWER PLAY AT VW

Chairman Piëch tightens his grip at the troubled automaker

BY GAIL EDMONDSON

EVEN FOR VOLKSWAGEN, a company accustomed to high-stakes management intrigue and boardroom drama, it has been a wild month. On Nov. 7, Chief Executive Bernd Pischetsrieder stepped down after an unexpected no-confidence vote by VW's board. On the same day, rumors started swirling that VW brand chief Wolfgang Bernhard, who has been at the center of the automaker's efforts to restructure, would soon follow Pischetsrieder out the door. Then on Nov. 15, Porsche upped its holdings in VW from 21% to 27%, fueling speculation that the giant carmaker might be taken over by the smallest player in Europe's auto industry.

The man behind all these developments is VW Chairman Ferdinand K. Piëch, one of the most controversial and powerful chieftans in the car business, scion of the legendary Porsche family, and a tycoon in his own right with a net worth of some $7 billion. Insiders at VW say that Piëch contrived the ouster of Pischetsrieder to reassert his grip on VW and speed change. Piëch, as the controlling shareholder at Porsche, also instigated the sports car maker's move on VW.

Is all this just a Machiavellian power play by Piëch to put himself back at the center of Volkswagen, perhaps at the expense of the company's future? Or is this Piëch's last act, a serious bid to restore VW's lost competitiveness?

A brilliant engineer but an obstinate and irascible manager, Piëch, who declined to comment for this story, already has a checkered legacy. During a 20-year stint at Audi, he pioneered breakthrough technologies and came up with hit cars. Moving to Volkswagen as CEO in 1993, he worked a turnaround but also overengineered VW's autos, spent billions buying and retooling luxury brands, and misread the market. In the late 1990s he stumbled badly trying to take VW upmarket in a bid to challenge Mercedes-Benz. VW even built a billion-dollar plant for Piëch's pet project, the $70,000 Phaeton luxury sedan. The Phaeton has never sold well, and today that plant is operating at a disastrous 10% of its production capacity, says one consultant.

The sting of those missteps may be driving Piëch to reassert control at VW. Auto industry executives say Piëch is determined to match the oversized legacies of his grandfather. Ferdinand Porsche created the VW Beetle and was the founder of Porsche, the most profitable automaker in the world. Like his grandfather, Piëch is intensely competitive. Now that Toyota Motor Corp. is the industry benchmark, Piëch wants to ensure VW can keep pace with the Japanese superstar. Says a top German

The Players in the VW Drama

	2006 REVENUES (BILLIONS)
VOLKSWAGEN* Target of an ongoing power struggle between supervisory board Chairman Ferdinand Piëch and other board members and executives. Piëch has ousted the CEO and has installed a loyal ally.	$138
PORSCHE Owns 27% of VW and teams with the larger automaker on R&D and production. May make bid for full control of VW. Piëch owns 13% of Porsche and controls all voting shares through the Piëch-Porsche family holdings.	$9.3
AUDI Piëch has transformed Audi, a VW unit, into a premium automaker. Could eventually be merged with Porsche.	$38.1

*Volkswagen group includes VW, Audi, Skoda, SEAT, Bentley, Lamborghini, and Bugatti.

PIECH An obsession with winning that may finally give him focus

nager: "Piëch wants to be revered as auto industry legend."

'ischetsrieder and Bernhard have al-dy made progress fixing the worst of 's problems. Bernhard, who joined company in 2005 after a manage-nt dispute at DaimlerChrysler, where was slated to run Mercedes, has been ely praised for overhauling VW's com-c approach to building cars. A ruthless t-cutter, Bernhard, 46, has a favorite nique: He routinely locks staffers in eting rooms, then refuses to open the rs until they've stripped $1,500 in ts from a future model.

SING MONEY

VW HAS A long way to go. The com-y is saddled with inefficient produc-n lines and the highest wages in the ustry. It loses money on every Golf Passat built in Germany. "VW is still leep trouble," says a consultant who worked closely with VW.

Key to Piëch's success will be a massive e for improved productivity. Much of heavy lifting will fall to Martin Win-orn, newly appointed head of VW and ose Piëch confidant. Formerly chief VW unit Audi, Winterkorn replaced Pischetsrieder, who clashed with the autocratic Piëch one time too many. Bernhard is still widely expected to depart, since Piëch passed him over for the CEO job in favor of Winterkorn, but insiders say Piëch and Winterkorn are seeking to persuade him to stay.

Piëch must whittle a still-bloated workforce, shutter unneeded plants, and introduce the kind of flexible labor practices that make Toyota's plants the yardstick in productivity. In addition to the 20,000 voluntary departures negotiated this year by Pischetsrieder, the company needs to get rid of another 20,000 people from the remaining 80,000-strong workforce, says Garel Rhys, professor of motor industry economics at Cardiff University in Wales. VW also has to develop processes that make cars easier to assemble. "Piëch has to grasp that nettle," says Rhys.

The payroll is bloated, and labor reform is a must

To do that Piëch has to learn from his mistakes. During a decade at the helm of VW, he led a turnaround by introducing models that customers craved. He was able to avoid layoffs, thanks to a cut in work shifts to 28.8 hours a week. But he also coddled labor leaders to ensure their support in power clashes with other board members. And he allowed costs to get dangerously out of control.

Managers close to VW say Piëch's obsession with scoring a win before he bows out may finally help him shed his engineering blinders and bear down on VW's lagging competitiveness. "Piëch is very intelligent. He understands that VW has to improve its cost structure and chase Toyota," says Ferdinand Dudenhoeffer, director of the Center for Automotive Research in Gelsenkirchen. So Piëch is unlikely to reverse Pischetsrieder's focus on mass-market cars. CEO Winterkorn plans to regroup the carmaker's seven brands into two, more logical, clusters: a mass-market division for VW, the Czech brand Skoda, and Spain's SEAT, and a premium cluster comprising Audi, Bentley, Lamborghini, and Bugatti.

One thing seems clear: Piëch isn't likely to use his family's control of Porsche to engineer a complete takeover of VW by the luxury carmaker anytime soon. Yet Porsche is already in the driver's seat at VW. And Porsche CEO and VW board member Wendelin Wiedeking will prove an important player. Wiedeking rescued Porsche from near-bankruptcy in the early 1990s. The Stuttgart-based sports car maker now has the highest margins in the industry, thanks in part to Wiedeking's embrace of Toyota's lean production techniques. To tackle German complacency at Porsche, Wiedeking sent planeloads of managers and shop floor workers to Toyota's plants and imported Toyota managers to train Porsche workers in Stuttgart.

Wiedeking is determined to make sure Porsche's $5.8 billion-plus investment in VW pays off. At recent board meetings, Wiedeking has peppered Pischetsrieder and Bernhard with detailed questions about VW's production processes, seeking comparisons to benchmark against Toyota.

Can Piëch and his team transform VW into a German Toyota? VW's 20% of the European market gives it massive leverage if it can produce more efficiently. It also has a 17.5% share of the fast-growing Chinese auto market. "If VW can get its costs down," says economics professor Rhys, "it would start to create a war chest to match or trump Toyota in every segment." ■

BUYOUTS

UP AGAINST THE WALL IN THE CITY

Why the London Stock Exchange may not be able to evade NASDAQ

BY STANLEY REED

SINCE ITS FIRST PUBLIC listing, in 2001, the London Stock Exchange has been the target of one takeover bid after another. So far, the LSE and its determined boss, Clara Furse, have managed to elude the net. But the $5.1 billion offer from NASDAQ announced on Nov. 20 could spell the end of the fabled exchange's independence.

Why? For starters, CEO Robert Greifeld of NASDAQ has the leverage other bidders have lacked. After just buying up an additional 7 million shares in the LSE, NASDAQ owns almost 29% of the British bourse. And Greifeld is motivated, even though the LSE rejected his latest offer. Snagging the LSE would bolster NASDAQ in its rivalry with the New York Stock Exchange, which would dwarf almost all other exchanges through its planned takeover of Euronext.

The LSE has also done better of late than either NASDAQ or the NYSE at attracting IPOs. So far this year, $19 billion has been raised in IPOs on the LSE, with an additional $5.8 billion raised on its small-company affiliate, the Alternative Investment Market (AIM), Dealogic says.

LESS RED TAPE

BY COMPARISON, THE NYSE's total is $4.7 billion over the same period. For NASDAQ, it's just $2.24 billion. Companies from Russia, China, and elsewhere find London more congenial than the U.S., in part because they encounter less red tape in Britain. So NASDAQ, long the premier venue for IPOs, needs the LSE to hold on to the crown. Greifeld also wants a piece of Europe's securities business, which is growing three times as fast as that of the U.S.

Global consolidation also makes a lot of sense. "If you had a clean sheet of paper and were designing the world's exchange system, you would never do it the way it is now," says Peter Weinberg, a founding partner of the investment banking firm Perella Weinberg Partners and former CEO of Goldman Sachs International. If eventually just a few changes were to dominate, NASDAQ would master the IPO and equities rea while Paris-based Euronext and the N York Stock Exchange could focus on uities, bonds, futures, and options. Chicago Mercantile Exchange would to dominate the futures market.

Both NASDAQ and the LSE neec bulk up to survive this race. Meanwh the London exchange faces the poss defection of key customers if it doesn't to reduce trading costs. "There is mo ing evidence that investment banks going to be putting more [comp tive] pressure on the LSE," says Kat Preston, director of equity researc Bridgewell Group PLC in London.

NASCENT REVOLT

THE BIG INVESTMENT banks say t are fed up with the service they get fi the Balkanized European exchanges, cluding the LSE. "We are the big clients, yet we just aren't treated w says one top London investment ban One of the top complaints: trading c in Europe that are 80% higher tha the U.S., according to the banks.

In hopes of lowering costs, seve the biggest banks—Mor Stanley, Goldman Sachs, group, Credit Suisse, Me Lynch, UBS, and Deut Bank —are planning to ate their own Europ trading platform. They're couraged by new Europ Union regulations desig to promote competition.

Earlier bids to build ternative exchanges in rope have failed. But banks figure the world changed enough for t to try again. The so involved in the Europ exchange project says technology of setting u exchange is now readily available f Sweden's OMX bourse and elsewhere

If the revolt of the investment ba gathers momentum, the LSE will h to cut costs, a task it can better acc plish with the economics of scal a larger group. Of course, the Bri may try to achieve those econon by merging with someone else. NASDAQ's Greifeld has the motivat the money, and the leverage to push bid to the end. ■

–With Kate Norton in Lon and Joseph Weber in Chic

HOT HAND This year, IPOs on the LSE have raised $19 billion

THE LSE IS IN PLAY

Data: Bloomberg Financial Markets

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CISCO

UNREST Union members protest Lone Star's Korea Exchange Bank deal

SOUTH KOREA

PUBLIC SCORN FOR PRIVATE EQUITY

Spurred by the outcry over huge profits, prosecutors are going after foreign firms

BY MOON IHLWAN

LONE STAR FUNDS OF DALlas is one of the savviest global investors around. Its managers have put more than $13 billion to work in buyouts and other deals around the globe. A big coup: bagging 51% of Korea Exchange Bank, one of South Korea's largest financial institutions, in 2003 for the low price of $1.5 billion. After cleaning out the bad debt and sprucing up customer service, Lone Star and its local partners were ready this year to sell out to Kookmin Bank of Korea for an estimated profit of almost $5 billion.

Lone Star, however, did not count on rising Korean wrath over the huge returns foreign private-equity firms have scored by buying and selling local assets. And Lone Star certainly did not count on aggressive prosecutors in Seoul delving into the Korea Exchange Bank deal for possible criminal wrongdoing. On Nov. 20 prosecutors indicted the Belgian company Lone Star set up to take over the Korean bank. The charge: stock price manipulation. On Nov. 16 a Seoul court even issued warrants for the arrest of Lone Star co-founder Ellis Short and Lone Star's general counsel.

The indictment caps almost a year of street protests, court maneuverings, and blistering newspaper editorials, all on the subject of Lone Star. The Texas firm declined to comment to *BusinessWeek*, but on Nov. 13, Chairman John Grayken accused the Korean prosecutors of making "slanderous claims against Lone Star and its employees." The ferocity of the Korean investigation has alarmed observers. "I'm worried about this pseudo-nationalist fervor being whipped up," says Kim Sang Jo, a leading shareholder activist. "This could discourage foreign investment." One local private-equity fund manager says he already knows of foreign investors who are steering clear Korea. Forei players now ha big exposure Korea. Non-K reans own some 40% of all shares trad on the Seoul bourse, while foreign dire investment has totaled some $90.8 b lion since the Asian crisis in 1997.

THE STAT

$90.8 billion

Foreign direct investment in South Korea since 1998

Data: Korean Government

Although the Lone Star case has t highest profile, other investment fun have come under intense scrutiny. In Ap prosecutors charged the local head of U.S based Warburg Pincus with insider tra ing in connection with the 2003 purcha of troubled LG Card Co.: He is still on tri Another U.S. fund, Newbridge Capit was investigated last year by the tax offi for allegedly making a $1.2 billion tax-fr profit from the sale of its interest in Kor First Bank. The tax office has declin comment on the probe's status.

Korean prosecutors accuse Lone St executives of manipulating the stock pri of Korea Exchange Bank's credit-card un which once traded separately from t bank. The prosecutors allege that af Lone Star purposely depressed the shar of the credit-card business, it scooped the subsidiary for a bargain price. A sep rate investigation is under way into legations that Lone Star executives brib regulators into letting the U.S. firm infl the value of bad loans on Korea Exchang books. That way, say prosecutors, Lone St got to pay even less for the bank.

FROM SAVIOR TO DEMON

KOREANS ALSO THINK the huge tax-fr profits earned by foreign funds in th country are a scandal. Tax authoriti have argued that many private-equ funds sheltered their Korean profits fro taxes by setting up companies in tax h vens to control their Korean assets.

Beneath the legal wrangling is dramatic change in Korean psycholo In 2003, Lone Star was hailed as a sa ior, the brave outsider willi to invest in financially tro bled Korean companies. No it's depicted as a demon be on making a quick buck a trampling corporate ethi underfoot. As one local p per, *The Herald Business* p it, no other tax evader w more "habitual and wicke than Lone Star. Whatever t validity of the prosecutio case, Korea risks reverti to an earlier suspicion of f eigners that sharply limit outside investment. ■

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The Next Wave

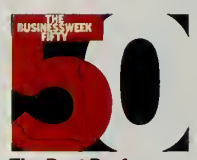
Six Sigma Still Pays Off at Motorola

The company is thriving, with a culture that lets left-brain and right-brain types coexist

BY ROGER O. CROCKETT

IT MAY SURPRISE THOSE WHO have come to know Motorola for its cool cell phones, but the company's more lasting contribution to the world is something decidedly more wonkish: the quality-improvement process called Six Sigma. In 1986 an engineer named Bill Smith, who has since died, sold then-Chief Executive Robert Galvin on a plan to strive for error-free products 99.9997% of the time. By Six Sigma's 20th anniversary, the exacting, metrics-driven process has become corporate gospel, infiltrating functions from human resources to marketing, and industries from manufacturing to financial services.

It's still paying off for Motorola Inc., too. Consider the hot-selling, super-slim Razr phone. A creative, innovative design, sure. Yet "Six Sigma's stamp is all over the Razr," says Michael S. Potosky, Motorola's corporate director of Six Sigma. Engineers, for instance, applied the process to the phone's antenna, helping keep it hidden while maintaining call clarity. With hits like the Razr, the Schaumburg (Ill.) company has climbed from a 15.4% market share in mobile phones to 22.4% over the past two years. Motorola netted $4.6 billion on $36.8 billion in revenues last year, helping it earn the No. 13 spot on the BusinessWeek 50 list of top corporate performers.



The Best Performers

COMEBACK

IT WASN'T ALWAYS THUS. In fact, Motorola stumbled in the late '90s, ceding its lead in mobile phones to Nokia. But one of the company's biggest feat in rebounding has been to allow the left-brain, analytical discipline of Six Sigma to coexist alongside the right-brain creative process without disrupting it. Six Sigma, broadly speaking, expresses a wa of thinking about business problems th encourages precision and predictabilit The mantra of Six Sigma "black belts" DMAIC, for "define, measure, analyze, in prove, control." The "sigma" refers to th Greek letter, which in statistics is used t measure how far something deviates fro perfection. The "six" comes from the go to be no more than six standard deviation away from that perfect measure.

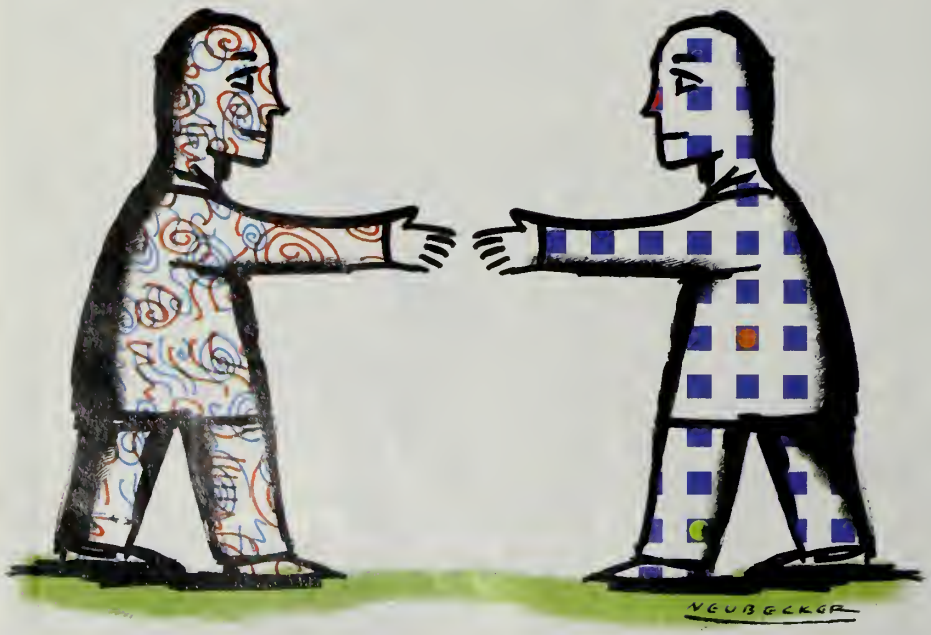
Innovation, by contrast, can be mess It is hard to sum up in a simple statisti and requires a healthy tolerance of failur "Innovation is, by its very definition, base on the idea that the value resides in th introduction of something unexpected, says Dev Patnaik, a principal at Jum Associates, a design strategy firm in Sa Mateo, Calif. When it comes to the breal through product, or the game-changin strategic shift, Six Sigma fans can "hav all the wrong reflexes," says Rita Gunthe McGrath, a Columbia Busines School management professor.

At Motorola, designers ar left to do their thing, but th process wonks will be close a hand, to make sure a cool proj ect meets a measurable cus tomer demand and gets built t quality standards. Unlike some companie newer to Six Sigma's esoteric methodol ogy, Motorola has people who accept it a part of the culture. Veterans are used t so-called project hoppers offering input a various stages in product development.

Others agree that Six Sigma an innovation don't have to be a cultura mismatch. At Nortel Networks, CE Mike S. Zafirovski, a veteran of bot Motorola and Six Sigma stalwart Gen eral Electric Co., has installed his ow version of the program, one that mar ries concepts from Toyota Motor's lea production system. The point, says Joe Hackney, Nortel's Six Sigma guru, is t use Six Sigma thinking to take super fluous steps out of operations. Runnin a more efficient shop, he argues, wil free up workers to innovate.

That's clearly a seductive line of think ing: About 35% of U.S. companies hav a Six Sigma program in place, accordin to a January, 2006, Bain & Co. stud "The past 20 years are evidence of hov many companies have picked up that [it works," says Potosky. But even a discipl like him stresses that in this era of th Big Idea, Six Sigma's success will onl come in a culture that not only welcome creative types and the metrics-obsessed but one that makes them both better. ■

–With Jena McGregor in New Yor



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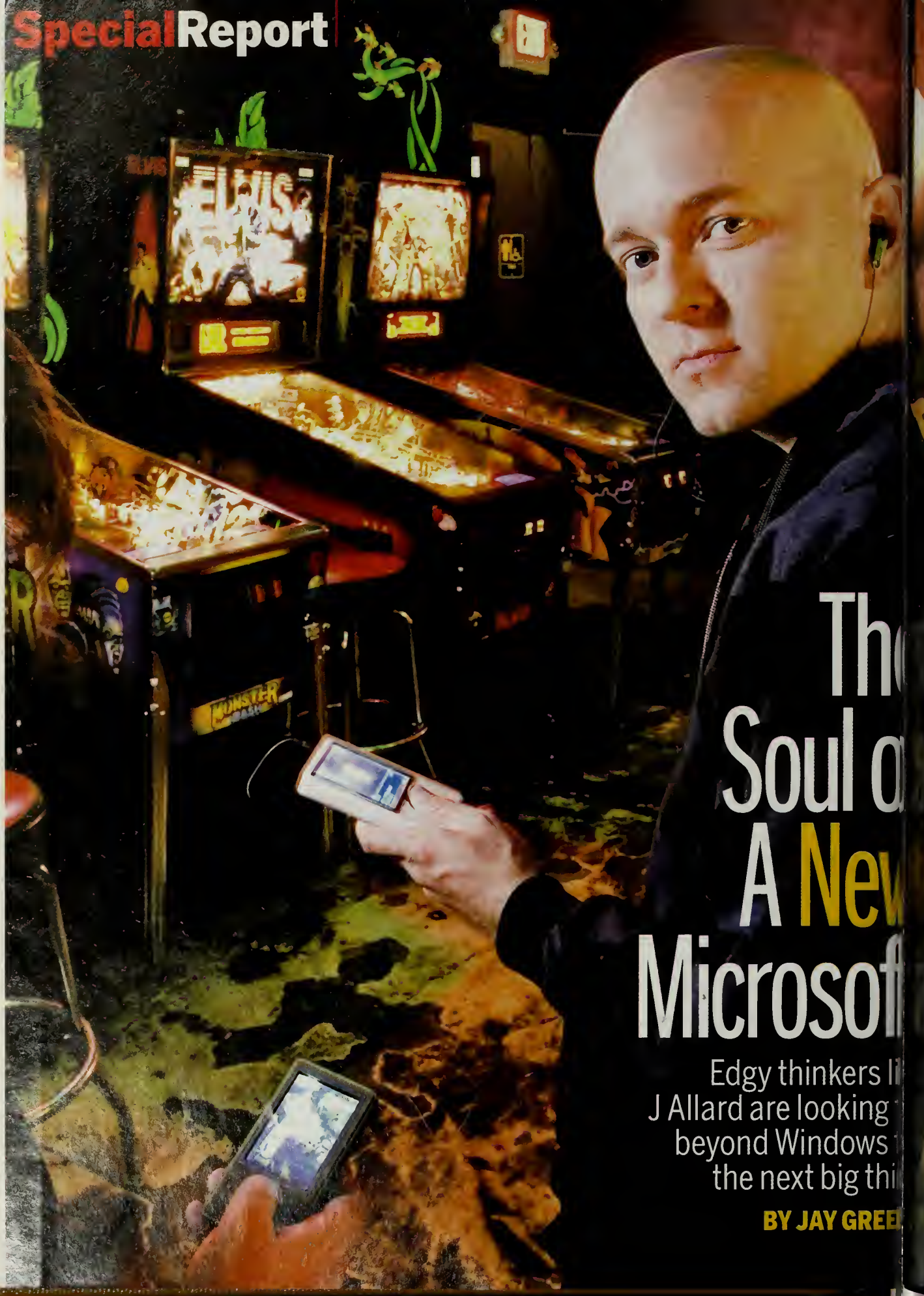


The Soul of A New Microsoft

Edgy thinkers like J Allard are looking beyond Windows to the next big thing

BY JAY GREE

FRE

AT 3:32 P.M. ON OCT. 19 AN E-MAIL flashed across the screens of the 230 Microsoft employees working slavishly to bring the Zune music player to market. The sender was their brash team leader, J Allard, 37. The message included a link to an old video of Steve Jobs on YouTube, mocking Microsoft's creativity. "The only problem with Microsoft is that they have no taste," the Apple Computer boss says. "They have absolutely no taste."

Allard was using one of the oldest motivational tricks in the book—his version of a football coach posting an opponent's quote on the locker room wall. "I for one...want to see this guy eat his words," Allard wrote. "Those are fighting words. He is speaking to every one of us and saying that we don't get it."

Zune hit store shelves on Nov. 14—a mere eight months after Allard's team got the go-ahead for the seemingly impossible task of toppling Apple's iPod music player. Contrast that with the five years and some 10,000 Microsoft Corp. workers it took to give birth to the latest version of the company's Windows operating system, Vista, which begins selling to corporate customers on Nov. 30 (and to consumers in January). From the start, Vista has seemed like an anachronism—packaged software in a Web 2.0 era where ever more applications are moving off the PC and onto the Internet, some springing forth in a matter of weeks. Microsoft Chief Executive Steven A. Ballmer vows that this time-consuming process of cranking out code, which created complexity and bogged down development, will never be repeated.

No one's suggesting that Zune will have anywhere near the impact of Vista. In its early form, it is clearly no iPod killer. It's bulkier and more of a battery hog, and the Zune Marketplace doesn't offer as many songs or videos as Apple Computer Inc.'s iTunes does. Plus, you pay for them with a confusing point system instead of dollars and cents. Zune will be lucky to sell 3 million units its first year and is sure to lose money for the foreseeable future. Vista, on the other hand, should run on about 76 million PCs by the end of 2007, says Roger Kay, founder of research firm Endpoi Technologies Associates. Vista sales should help fuel $11.5 billion contribution to operating profits from Windo in the current fiscal year, says Credit Suisse First Boston ar lyst Jason Maynard.

But maybe the point is that Microsoft needs to find un-Vista. Several of them, in fact. The software giant is e tering perhaps the greatest upheaval in its 30-year histo New business models are emerging—from low-cost "ope source" software to advertising-supported Web services that threaten Microsoft's core business like never befo For investors to care about the company, it needs to find n growth markets. Its $44.3 billion in annual sales are putt ing along at an 11% growth pace. Its shares, which soar 9,560% throughout the 1990s, sunk 63% in 2000 when t Internet bubble burst, and they have yet to fully recov

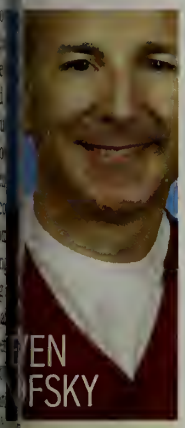
Reigniting growth will require a cultural shift at a comp ny that has long shaped its strategy around maintaining Windows operating system and Office word-processing a spreadsheet monopolies. That calls for a new breed of lead who can push the company in directions it hasn't gone befo "Things are different from the desktop world that most of t Microsoft guys grew up in," says Michael A. Cusumano management professor at Massachusetts Institute of Techn ogy who has written extensively about the company.

No one leader will replace William H. Gates III, t iconic software geek who came to define an era and plans leave the company in June, 2008. But a cadre of execs is po tioned to step up. Steven Sinofsky, the longtime head of the fice unit and onetime Gates technical assistant, has been put charge of speeding up the Windows product cycle. Ray Ozz a relative Microsoft newbie and computing industry icon, working to Web-ify many of Microsoft's products.

The soul of the new Microsoft, though—its Geek 2.0—m just be Allard, the vice-president for design and developme at its Entertainment & Devices unit. Allard looks and a nothing like the prototypical Microsofty. Over the years h swapped his plaid shirt and khakis—something of a Micr soft uniform—for edgy jackets made by Mark Ecko and oth designer wear. He loads up his nine iPods, and now his Zu with songs from hardcore bands like A.R.E. Weapons. A he's a downhill mountain biking maniac who has broken s eral bones after flying off his bike.

crosoft: The Change Agents

ill Gates prepares to step away, a new breed of leaders is retooling the company and searching for th opportunities. In addition to J Allard, here are five others to watch:



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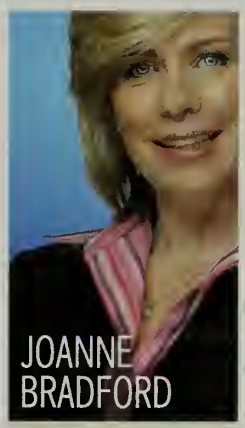
>Brummel took over human resources in April, 2005, at the nadir of employee discontent. She changed policies on everything from worker rankings to providing gym towels.

LISA
BRUMMEL



JOANNE
BRADFORD

>MSN's chief media officer is pushing into the ad sales business and leading an effort to let advertisers target users by gender or Zip Code. Can she extend that to Xbox and Internet TV?

>Muglia leads the one big growth engine: The server business. He's also responsible for the billions Microsoft is spending to expand its Web services infrastructure.

BOB
MUGLIA

SATYA
NADELLA

>Nadella has been given the small-business software group. He's trying to create new markets around run-the-business software, expanding Office beyond its core applications.

More important than his cool quotient, though, is that Allard s things done—fast. Zune is only the latest example. At the n of the decade, he led the software giant into the video game siness with Xbox, a risky gambit that's just starting to pay off. ox is now a solid No. 2 to Sony Corp.'s PlayStation, and ana- ts expect it to turn its first profit in the next fiscal year.

Allard is one of more than 100 Microsoft vice-presidents, t he has played an outsized role in shifting perceptions about whether the company can innovate in areas other than packaged software. In June, when Gates announced his plan to focus full time on his charitable foundation, he anointed Allard, along with a handful of others, as the leaders he expects to clear new paths.

Already, Allard and those like him are having an impact. They're showing that strategies to move the company beyond Windows can emerge and be accepted by top brass as

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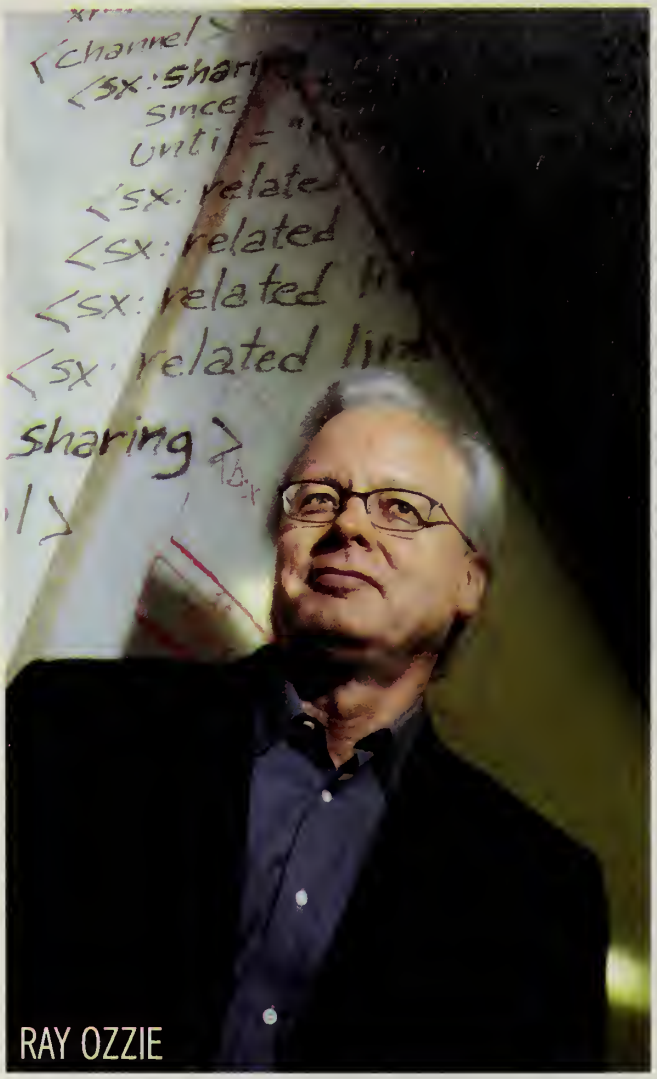
Sun microsystems share



RAY OZZIE

nonthreatening. A key moment came six years ago, when Allard insisted that the new Xbox video game console be developed without using Windows. In one meeting, Gates berated him for suggesting that the operating system wasn't up to snuff. But Allard argued that it wasn't specialized enough to handle video gaming. Gates eventually relented, in a decision that is widely seen today as a key to the console's success.

Even Ballmer, once pigeonholed as a micromanager, seems increasingly willing to distribute power and let those underneath him try new approaches. "I would have been hell-bent and determined six years ago to call Xbox the Windows Game Machine," he says. "My natural tendency would have been to call Zune something that was related to Xbox, since we had some consumer franchise. And yet we're really building consumer marketing muscle, and those guys are really teaching and educating us on new ways to do things."

Chief Software Architect Ozzie is forcing the biggest changes, pushing Microsoft to Web-ify most of its products

Never afraid to speak his mind, Allard started pushing bu tons way back in 1994, when, as an eager 25-year-old pr grammer only three years on Microsoft's payroll, he penne a sea-changing memo titled "Windows: The Next Kill Application on the Internet," which found its way to Gate The note, now part of Microsoft lore, helped awaken Gat to the potential and threat of the Web. "I'm a pain-in-the-a change agent," Allard says.

That's exactly what Microsoft needs if it hopes to agai set the tech agenda. Windows and Office will deliver mo revenues in coming years than the exports of many small n tions. But Web spitfires such as Google Inc. and Salesforc com have the wind at their backs. And while Microsoft co tinues to recruit top talent, it also continues to see key leade move on: executives such as Vic Gundotra, a top evangelist i its developer division, who will soon join Google, and Bria Valentine, the longtime leader of the Windows server bus ness, who now works for Amazon.com Inc.

Nowhere are Microsoft's missteps mo apparent than in digital music. When that business fir emerged five years ago, the company saw it through Wi dows-colored glasses. Using the same model that worked i PCs, Microsoft produced software to play music on compu ers and handheld devices, slapping the Windows brand o it and leaving the hardware design to partners. Microso figured Apple was making the same mistake it made wit the iPod as it had made with its Macintosh PCs: By creatin both the proprietary hardware and software, it would lo out partners and limit growth.

But it turns out the silky experience of hardware marrie inextricably with software was crucial in coaxing nontechi into the world of digital music and downloading. Microsoft market share pales in comparison with Apple's because i software never worked smoothly with devices that came fro partners such as Creative Labs and with services from outfi like MTV. Apple seized 85% of the song download busine and to date has sold 67 million devic and 1.5 billion songs.

When Allard's team hatched Zun they unabashedly cribbed from Apple playbook. Microsoft all but abandone its music partners, built its own devic and offered its own music-selling servic Moreover, the player and service, whic work exclusively with one another, ope ate far more smoothly than any previo iPod challenger.

Allard recognizes, though, that he ca beat Apple by merely mimicking its be features. So he wants to change the rul of the game. That's why he led the effo to include wireless fidelity, or Wi-Fi, insid Zune. Zunesters can use it to beam son to friends' devices. Microsoft cut dea with record studios, persuading them t let consumers share music in a tolerable way; Zune includ technology that limits beamed songs to three plays or thr days, whichever comes first. Labels bought into the idea of pr motion. "My customer becomes your street team," Allard say

Microsoft is betting that Zune will follow the path of Xbo Like the game machine, Zune arrives as a flawed first versio

uan Ignacio Sanz Peciña, Technology Director, Transport and Traffic.
traffic control
ain is a leader in well-being and quality of life and s reached an excellent level of socio-economic velopment. Spanish businesses are very sensitive to e environment and sustainability and are also tstanding in their achievements in technological search and development.
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that screams for an update. And like a much criticized networking feature on Xbox that eventually gave it an edge when online gaming took off, Zune's Wi-Fi technology hints at a broader vision.

Sitting in the open, communal meeting space at the center of Zune headquarters—a refurbished dance studio a few miles from the main Microsoft campus—Allard wonders why every pundit is so focused on the device rather than the listening experience. He envisions a time (not soon, mind you) when all of your music will be "in the cloud"—tech-speak for Net-connected servers that dish up content wherever you happen to be, beamed to any device. Hop on a plane, plug headphones into the armrest and poof!—there's your music. Set your hotel alarm clock to wake you to your favorite song. Zune may be a swell device, but for Allard it's a means to a much larger end.

The giant of Redmond is starting to take an Allard-like fresh look at many of its older product lines, as well. Webification can be seen seeping into all corners of Redmond (Wash.) headquarters. Its leading proponent is Ozzie, who developed Lotus Notes in the 1980s, then joined Microsoft in 2005 when it acquired his Groove Networks. Ozzie quickly emerged as heir to Gates's role as technology sage. Under the year-old "Live" strategy, Microsoft is blending services it launches on the Web with programs consumers run on their PCs. That way, Netizens get a better experience using Web services when they harness Windows and the processing power of PCs. Take Windows Live Mail, a small software program that lets users view various e-mail accounts—even Google's Gmail—in the same window. Because it runs on a PC desktop, it's easy to include zippy features such as automatically completing an e-mail address after you type in a few keystrokes. Microsoft will give away services such as e-mail, limited Web hosting, and perhaps one day that portable jukebox in the sky Allard dreams of, making money from advertising and subscription

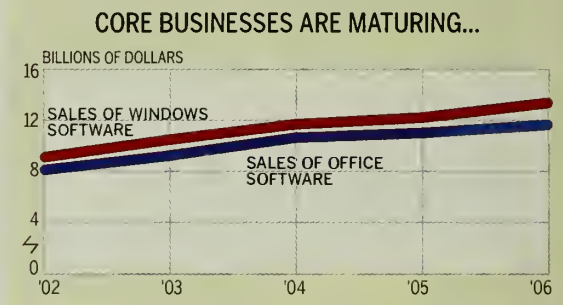
Challenging Google on th Web and Apple in music a stretches for a company th critics say lacks a culture innovation. But while near all the profits are from the ol products, the growth oppo tunities are in the business Allard and Ozzie are ignitin Xbox, for example, should rin up $4.6 billion in sales in th fiscal year that ends next Jun says Goldman Sachs & C analyst Rick Sherlund. Th number should climb 67 to $7.6 billion, in fiscal 200 He estimates that Zune sal will climb from $250 millio to $575 million over the sam period. By that time he expec the Home & Entertainme unit, which includes Xbox an Zune, to kick in $1.2 billion i operating profits.

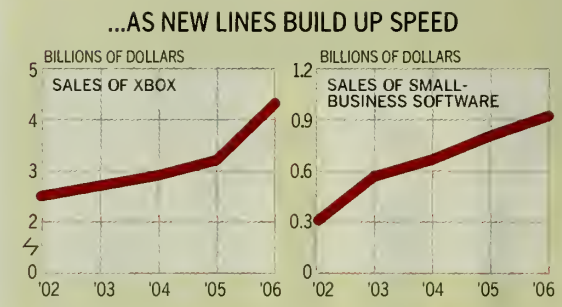
Lately, some outsiders wh work with Microsoft dete signs that the culture is slow shifting as well. "They're de nitely in the middle of a stra egy re-look," says Hewlet Packard Co. chief strategy an technical officer Shane V. R bison, who chats with Micr soft brass. "It will be a fair orderly evolution, but there a lot of new discussion that I'm seeing."

There's hardly anything old school about Allard. On drizzly fall night in the Seattle suburb of Issaquah, he se out with some Microsoft mountain biking buddies for a ri through a pitch-black forest. Guided only by lights moun ed to their helmets and handlebars, the group bumps ov tree roots, splashes through puddles, and powers over trail some no more than two feet wide. Allard hustles his bike yet another hill, then stops to catch his breath and check h heart-rate monitor. It's racing high, at 197 beats per minut A minute later he's back in the saddle, looking for the ne hill to climb.

A Tale of Two Microsofts

Windows and Office still pay the bills but don't provide the rapid growth they once did. Microsoft is tapping new markets with products like Xbox and its Dynamics small-biz software.





Data: Microsoft Corp.

Everything with Allard

is about velocity. He driv a Ferrari 360 and a Porsche 911. He bombs down ski runs du ing the summer on a mountain bike at speeds topping 30 mil an hour. He qualified for the U.S. Nationals race this summ but had to drop out after he was hit by a car while bikir around Seattle. "I love that gravity is unforgiving," he say He even blazes through e-mail, jotting down notes all in low case: "shift key slows you down," he writes.

His fascination with technology and commerce started ea ly. When Allard was about 12, he wrote an elaborate comput game called Lemonade Stand. The proprietor started with $5 allowance to buy sugar and lemons. You had to look weather reports; if you guessed wrong and made too muc

Take a Closer Look

See a video interview with the executives in charge of Windows and Office.

Listen to Executive Editor John A. Byrne's interview with Jay Greene at businessweek.com/podcast.

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lemonade, it would go bad and take your investment with it. "If I had half a brain, I would have waited 10 years, called it Sim Lemonade and made a bazillion," Allard jokes.

A B+ student who thrived on math, Allard dove deep into computer engineering at Boston University. He and his future wife, Rebecca Norlander, impressed a Microsoft recruiter enough at an MIT job fair to get two tickets to Seattle for a full round of interviews. (Norlander also works at Microsoft, most recently as general manager of the security business unit.) During one session, Brian Valentine, then a networking manager, asked Allard what he'd want his epitaph to read if he died tomorrow. There was little hesitation: "Go big or go home."

In college, Allard had become addicted to the Internet. Raw as it was back then, he connected to others with similar interests and had an inkling of the power it held to bring together the masses. But Microsoft had no clue. It had registered microsoft.com as an Internet domain name only a few months before Allard landed, more than five years after Sun Microsystems Inc. registered its name. Microsoft was far more interested in desktop computing than figuring out how to make all those computers work together.

Three years into his Microsoft tenure, Allard was working on Windows NT server software, with no direct reports. Frustrated, he wrote his now-famous memo. Allard wanted Microsoft to figure out what Internet users wanted to do, build tools to help them do it, and become a technical leader before rivals did. "Embrace, extend, then innovate," he wrote. "Change the rules: Windows becomes the next-generation Internet tool of the future!"

That message, along with an e-mail to Gates from Sinofsky, served to awaken the slumbering company. Allard became a star, and Microsoft focused on connecting customers through its server and PC software, crushing Web browser pioneer Netscape Communica tions Corp. along the way.

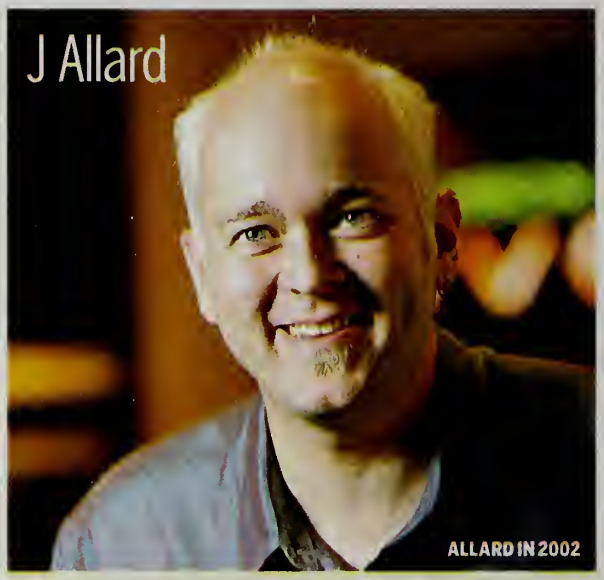
But the Net and Microsof were still an awkward fit. I the late 1990s, Allard was pu in charge of a wildly elabo rate Web-services initiativ dubbed Project 42. The grou took its name from the cul classic book *The Hitchhiker' Guide to the Galaxy*, in whic the absurd answer to th question "what is the mean ing of the universe?" is: 42.

Allard now says he use the name in part because th group's goals seemed equall absurd. Its roster expanded t an unmanageable 1,500 work ers, and the project became clearinghouse for every We idea that bubbled up. "W started with the organizatio first, not the dream," Allar recalls. "It was quickly th answer to everything." Tear members sparred over dif ferent visions for the Web Would it be tightly couple to Windows or open to othe technologies? In May, 199 Project 42 disbanded, collaps ing under its own weight.

Microsoft's longtime Wir dows chief, James E. Allchi later described the effort a "incredibly ambitious an naive." Allard pondered tha barb recently and wondered it's really a knock. "The onl way to change the world i to imagine it different tha the way it is today," he say "Apply too much of the wis dom and knowledge that g us here, and you end up rigl where you started. Take a fres look from a new perspectiv and get a new result."

Allard took two months o and pondered his next gi Based on the Project 42 deb cle, he knew he had to start small: "The critical lesson wa Crawl, walk, run." A handful of buddies working on an idea t build a video game device needed someone with political clou Allard still had sway with Gates and Ballmer, so he dove in.

Just like the pre-Internet days, Microsoft was stuck thinl ing conventionally. Allard's bosses wanted to develop a vide game version of Windows and get computer makers, such a Dell Inc., to build the device. But the industry didn't work th way. Hardware makers lose money on console sales and mal it back from royalties on games. When it became clear th Microsoft had to enter the console business, building fro scratch wasn't his superior's first choice. "I wanted to acqui



ALLARD IN 2002

BORN Jan. 12, 1969, Glens Falls, N.Y.

CHILDHOOD Oldest of three children. Grew up mostly in upstate New York, aside from 1½ years in Sweden, where his dad, a paper industry executive, was posted.

EDUCATION BA, computer science, Boston University, 1991.

FIRST JOB At 14 worked at Ray Supply, a computer store.

MICROSOFT CAREER Joined the company out of college, working on networks before the brass even understood much about them. Was the technical brains behind Xbox before moving to his current post overseeing design and development at Microsoft's entertainment division. Was the visionary for Zune.

NICKNAME Was called James into college, then dropped the last four letters because there were so many other Jameses.

FAMILY Married his college sweetheart, Rebecca Norlander. No children.

FIRST ALBUM KISS, *Alive!*

MOST-PLAYED TUNES ON HIS ZUNE *Don't Be Scared* (A.R.E. Weapons); *Guerilla Radio* (Rage Against the Machine).

HOBBIES An avid mountain biker, he put together a team of pals, Project 529, and got top sponsors to sign on.

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Nintendo," recalls Rick Thompson, a vice-president who then ran the hardware business. Allard pushed to do the whole project in-house, and Microsoft ultimately vaulted ahead of Nintendo.

Allard's reward for the success of Xbox was being put in charge of finding new multibillion-dollar device businesses, which became the quest to topple Apple's iPod. The enemy in this case is very familiar: Behind Allard's desk is a crystal given to him by his boss, Microsoft entertainment division President Robert J. Bach, upon his 15th anniversary at the company. In the middle sits a photo of Steve Jobs. Always the iconoclast, Allard works on an Apple G5 computer, next to an obviously less frequently used PC. Allard says it's important to learn about the competitio

Allard has surrounded himself with a small posse of lo colleagues who move with him from project to project. Dou las C. Hebenthal started with Allard 15 years ago on a n working product called LAN Manager. Hebenthal ticks off t big assignments they've shared since—Internet Informati Server, Project 42, Xbox, and now Zune. "In every case which I work with J, there is a mountain to climb, there is clear leader, and most folks would see that mountain as i surmountable," he says. "The thing about the guys who wo with J is that we never think things are insurmountable. fact, that's the draw."

–With Peter Burrows in San Mateo, Ca

Polishing the Windows, Spiffing Up the Office

The long-delayed Windows Vista, which makes its debut on Nov. 30 along with Office 2007, is leading Microsoft Corp. to rethink the way it develops software. Seattle Bureau Chief Jay Greene interviewed Kevin Johnson, co-president of Microsoft's platform and services division, which makes Windows, and Jeff Raikes, president of Microsoft's business division, which is responsible for Office.

RAIKES AND JOHNSON: MARRYING SOFTWARE AND SERVICES

Kevin, for most companies, Windows XP works just fine. Why rush out and buy new PCs with Vista on them?

JOHNSON: The investments we've made in Windows Vista and the 2007 Office System and Exchange [e-mail software] are all about unleashing the next wave of productivity. Customers in the last several years have probably done more cost containment coming off the Y2K investment, coming off the dot-com bubble. There was an overinvestment in technology, so they've been very focused on reducing the cost of owning and operating. Now, cost containment is still important, but a lot more priority is being put on driving top-line revenue. There are massive amounts of data in corporate databases on people's PCs. The more you could turn that data into meaningful information, the more you connect people with colleagues and co-workers, you're going to unlock another wave of productivity.

The gap between Windows releases was five years. What are you doing to ensure that won't happen again?

JOHNSON: There's a set of things that we've done with the engineering system so that we can have a more agile process. And there are certain things that we're doing in the product itself, ensuring that we have better line of sight of the different components and how they relate to one another.

Is one of the core lessons that with Windows, you need to think smaller?

JOHNSON: One of the values in our company is really taking on big, bold challenges. And I think that's an important attribute for us to retain. The key is how we execute—if you try and jam all of those big, bold aspirations into the next releases vs. taking a multi-release type of perspective.

In the Web 2.0 world where everything seems to be moving online, it almost seems anachronistic to be talking about packaged software.

RAIKES: The new world of computing is the combination of software and services, and Microsoft is very, very focused on that services opportunity. I think the point that some of the competition misses is they think of it as an either/or situation when in reality it's an "and" situation—it's software and services, and you use the combination to do the best job for the customer.

But doesn't the growing importance of the Web and all sorts of devices require Microsoft to take a different approach?

RAIKES: You might think the core of our business is the PC. That's the misconception. The core of our business is software. And the software can be applied to the PC, the software can be applied to the server. When K.J. [Johnson] was joining the company [14 years ago], servers were kind of just getting started for us. Now we're big in game consoles. Did we want to get into Xbox because we wanted to be a hardware company? No, Xbox is a vehicle that allows us to deliver software. Zune is about software. So we are about software, and if you stick to that understanding of our company, then it's a lot easier to see how we transform.

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The Future of Tech

Thumbs Up
Park, in Seoul: Your future could look a lot like her present

KI HO PARK/KISTONE

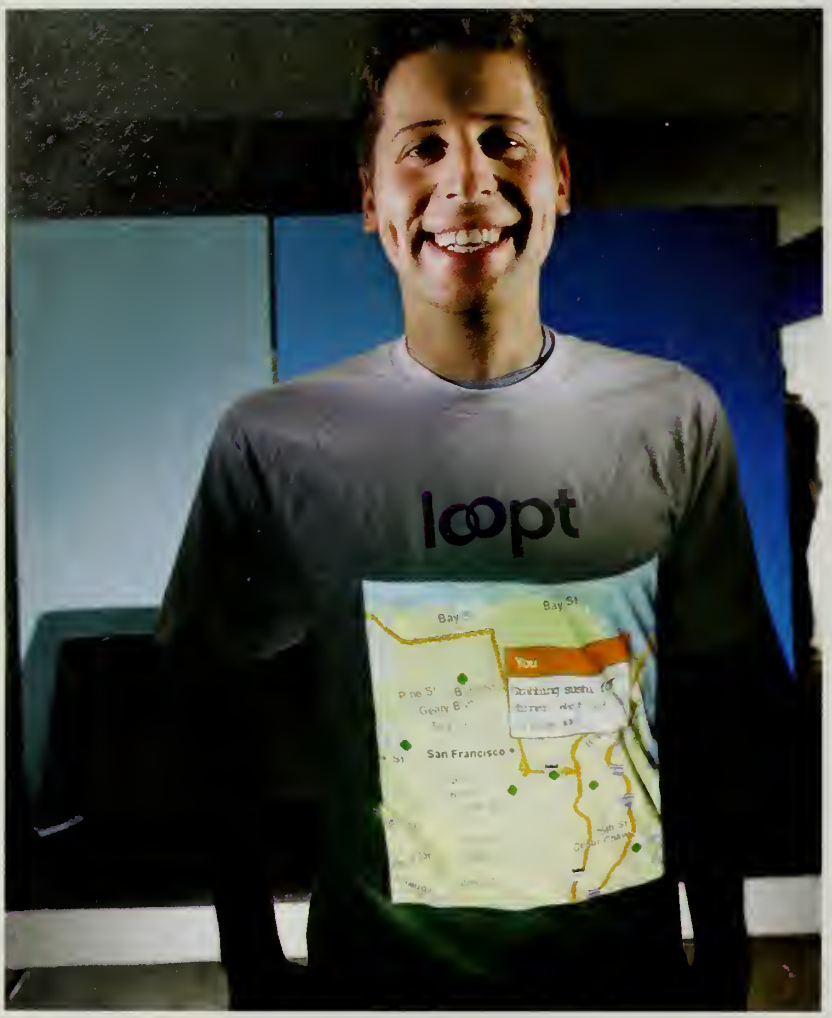
Upward Mobility

Ultrafast networks and whizzy features are about to turn your cellphone into—well, your right arm

BY CLIFF EDWARDS AND MOON IHLWAN

PARK HYUN-A IS SOMEONE you might want to watch. A 21-year-old student at Korea University in Seoul, she'd like to be a marketing executive for a telecom or fashion company someday and enjoys playing matchmaker for friends looking for the perfect mate.

But what's really intriguing is the way Park uses her Samsung mobile phone. Each day she waves it over a reader at a turnstile in the train station to pay her fare. Then, during the long ride to school, she flips open the screen and rotates it 90 degrees to watch satellite TV. On the same screen, Park pages through an e-book version of Joachim de Posada's *Don't Eat the Marshmallow...Yet!: The Secret to Sweet Success in Work and Life*. She sends an average of



Sam Altman

Co-founder of a startup called Loopt, the 21-year-old built a business around the numero uno question in text messaging: "Where R U?" In mid-November, Loopt launched a service for subscribers with phones that contain location-savvy GPS devices. Loopt is aimed at members of social networks who want to keep constant tabs on one another, aided by pictures, maps, and alerts that sound when a friend is nearby.

66 text messages a day, snaps pictures of cute guys and sends them to friends, and plays an online game in which she runs a virtual fruit store. "I can hardly think of my life without my handset," Park says.

A lot of us in the U.S. already feel the same way. Whole industries are now reconfiguring themselves to keep feeding the addiction. In the past year, cellular-service providers and phonemakers have begun moving to faster networks, including something new called WiMAX, which is like Wi-Fi writ large. The transition will accelerate in 2007, beginning in January with two giant industry trade shows. These will unleash a flood of innovative mobile gadgets and services, like those enjoyed by Park Hyun-a and her friends, that will stretch the definition of wireless as we know it.

The term "cell phone" certainly doesn't do justice to Park's polymorphous handset. Two of the networks this phone may soon run on—Wi-Fi and WiMAX—don't even use cell towers. That's why Motorola Chief Executive Ed Zander refers to such gizmos, his own phones included, as "the device formerly known as the cell phone."

This latest phase of the mobile revolution is intimately tied to the abrupt rise of media-ric social networks such as Google Inc.'s YouTub and News Corp.'s MySpace.com. Groups friends crave connectedness, and they achiev it by swapping photos, music, and video clip immersing themselves in a shared, sensu chronicle of daily life.

To participate, you used to have sit in front of a computer scree But a host of advances, includin faster network speeds, exotic ne batteries, and bright, energy-efi cient screens for mobile gadget could cut some of the last tethers the PC. The handset, stuffed with content yo purchase or create, will become your person television network, your music studio, and yo wallet for dispensing digital money. It coul also become your personal location servic Today, cars with satellite-mapping softwa can tell you how to get to your destination. Phd nemakers are now building the same kind technology into their handsets, which, amon other things, can send out an emergency bea con that summons your friends to rescue yo from a bad date.

It's not just gadget makers that need wrestle with the implications of mobility. Ad vertisers will have to recalibrate their busine models to safeguard privacy, and users wi have to be able to opt out of solicitations aime at their mobile devices.

Startup computer services with names li ipsh! and Mobo are laying the foundations f this, creating a framework for you, the consun er, to form covenants with your trusted vendor As you walk down the street, the services migl let you know that those Juicy Couture jeans yo wanted are on sale a few blocks south, or th Chez Panisse has two seats available at 7 p.r Stores will know you're in the vicinity becau you have sent a text message to a computer th notifies the vendors you trust—or maybe you allow them, at certain moments, to "sniff" t chips in your phone that uniquely identify as yours.

If some of this sounds familiar, it's b cause the ideas go back to the early days the dot-com boom. PocketTV and locatio based marketing were two recurring them of the telecom bubble that culminated abo five years ago in frothy European auctions "third-generation" wireless spectrum. Carrie dropped tens of billions of dollars at these au tions, expecting mobile commerce to explod But neither the hardware nor the clever appl cations were ready for prime time.

Much has changed in five short years. F starters, wireless carriers and handset make have made progress on hardware and softwa

Continued on page 7

Global Financial Services

Ireland – A key location in the Global Financial Services Industry

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In the technologically driven, fast paced global business environment of financial services, customers, services providers and investors have gravitated towards key global locations. Ireland has emerged as one of the newest and most successful International Financial Services locations in the world.

Since the formation of the International Financial Services Center (IFSC) in 1987, Ireland's position in the international financial services industry has undergone a complete transformation, evolving from an industry serving local market needs into one of the world's leading financial hubs. It has also contributed to and mirrored Ireland's much admired economic development, particularly over the last decade.

Dublin is now internationally recognized as a choice location of the international financial services industry, ranging from banking and treasury to insurance and funds. This is largely due to Ireland's reputation for highly-skilled and experienced people, the 'can do' business attitude, responsive legislation and flexible, speedy regulatory procedures.

The listing of international financial services companies reads like a "who's who" of top global financial institutions with companies such as Citigroup, State Street, Depfa Bank, JP Morgan, HSBC, Merrill Lynch, XL, Hartford and ABN Amro managing European and global functions from Ireland. Ireland is now home to half of the world's top 50 banks and one of the main European locations for insurance (both life and general) and an internationally recognized hub for the funds industry. Up to 24,000 professionals work directly in the industry today, with as many again employed indirectly in support services, such as legal and tax advisory services.

Some highlights which give an idea of the scale of operations in the IFSC are:-

- Bank assets of international banks are now worth over $473 billion
- Net asset values of domiciled investment funds are €810 billion
- Cross-border life assurance premiums are €15 billion

The success of the IFSC has led to the growth of non-regulated financial services activities, expanding into locations throughout Ireland. A key element of the Irish government's strategy is to continue to encourage and support the development of financial services activities beyond the greater Dublin area, ensuring Ireland and not the IFSC alone is internationally recognized as a first-class location for the industry. A growing number of companies are already doing this by adding operations centers and back office and administrative activities, with strong clusters of these activities being developed in several regional areas across Ireland.

International financial companies in Ireland

Examples of companies choosing locations outside o Dublin include IFS and BISYS expanding their operations with new regional operations in Drogheda, Naas and Waterford, while PFPC has built on its positive experiences in Wexford and is expanding its existing facility and opening a new office in Navan. Other companies that have found success outside the IFSC include Sun Life in Waterford, Northern Trust in Limerick, State Street Bank in Kilkenny, GMAC in Mullingar, MBNA - a Bank of America company in Carrick-on-Shannon, Cigna in Galway and Pramerica and Pacificare in Letterkenny.

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International Banking

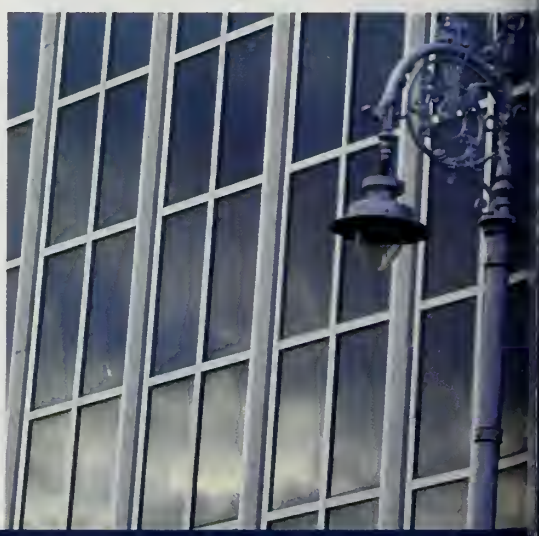
Since 1987, over 160 banks and asset financing companies have established operations in Ireland. Activities are concentrated on international lending, asset financing and securitization. Total assets of banks based in Ireland stands at around $924 billion.

Fund Management, Custody and Administration

Ireland is firmly established as a leading international center for mutual funds, registering strong growth patterns year after year. More than $1.26 trillion worth of funds are serviced from Ireland. Over 4,400 funds and sub-funds are managed from Ireland, with some 3,800 domiciled in the country. Ireland presents the International Mutual Funds Industry with an unparalleled set of attractions, both as a domicile for funds and as a center from which to administer, market and service funds. The advantages include the range and flexibility of fund legal structures available in Ireland. Dublin has over 265 international fund promoters from 30 different countries, including industry leaders such as Barclays, BNP Paribas, Daiwa Securities, Deutsche Bank, Fidelity, Northern Trust, Goldman Sachs, HSBC, Merrill Lynch, Pioneer and many others.

Insurance, Reinsurance, Life Assurance, Captives

Many of the world's top insurance companies are operating in Ireland, proving its attractiveness for the insurance sector. Companies including AIG, Hartford, MetLife and Sun Life have established operations in Ireland. Current figures indicate that the sector's assets are valued at $43 billion. In the life assurance sector, world leaders such as Generali, UBS and Scottish Equitable offer protections/investment products to international clients from Ireland. Ireland is now the seventh largest reinsurance market in the world.



and, knowledge in our nature

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e independent D World mpetitiveness port ranks land as one of e best countries the world for e quality of ucation meeting e needs of a mpetitive onomy.

Corporate Financial Services:

Ireland has an excellent reputation as a European center for corporate treasury operations, both stand-alone and outsourced. It offers blue chip companies the opportunity to obtain a banking license. Companies that have chosen Dublin for stand-alone and global treasury activities include Porsche, IBM, Wyeth, Pfizer, Ericsson, Volvo, GE, HP and Volkswagen.The IFSC is a well developed hub for aircraft leasing and financing companies from the US, Europe and Asia. These include Airbus, Boeing, Babcock & Brown, GE, Orix Aviation Systems and CIT.

Research & Innovation in financial services in Ireland

The Irish government pursues a carefully planned, integrated R&D strategy, encompassing all of the key elements necessary to achieve world-class R&D. The creation of knowledge within the financial services industry is high on the agenda.

Recently, Citigroup announced the establishment of a Research and Development Center of Excellence at its Dublin offices in the International Financial Services Center. This is the first dedicated R&D Center established by Citigroup worldwide and the first ever R&D investment by an international financial services company in Ireland. The Center will be responsible for the development of products and services for Citigroup's Global Transaction Services unit from 'concept to commerce'. Research will initially focus on innovative solutions for the investment management industry.

Recipe for Success

Since 2003, a corporate tax rate of 12.5% applies to corporate trading profits in all sectors and activities carried out in Ireland. It is a founder member of the Euro and the only native English speaking member and common law jurisdiction in the Euro Zone.

The increasingly complex financial services industry has found a location of success in Ireland, where the activity profile has migrated from transaction based activities into sophisticated, knowledge led global financial management.

The key factor in the success and growth of Ireland's international financial services industry has been the team Ireland partnerships encompassing various government departments and agencies, the regulatory environment, the industry itself, the supporting professional services and the deep talent pool.

Irish people are widely travelled and are open to global influences. They are creative and pragmatic and have an innate ability to empathize and to influence; they are solution seekers with a 'can do' approach.

"The staff of Citigroup Ireland has demonstrated a strong ability to manage complex global banking and transaction services. A number of cross border products are today fully managed out of Ireland with a global footprint into 108 countries. We are excited by this initiative and proud to take an innovative lead in the financial services industry in Ireland. This is a significant addition to our Irish operations and firmly places Ireland as one of the most successful Citigroup locations worldwide."

Aidan Brady, Country Corporate Officer, Citigroup Ireland

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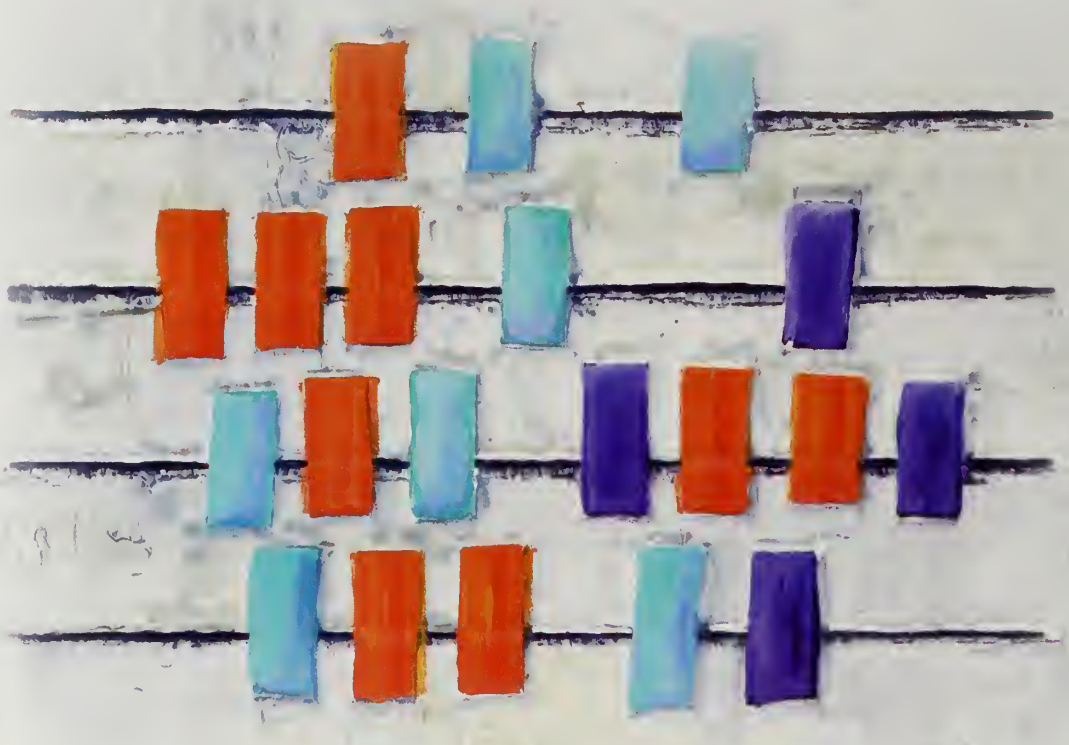

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The Many Faces of Mobile

SAMSUNG/BANG & OLUFSEN SERENE

Consumers are flocking to mobile devices that satisfy fashion tastes as much as functional needs.This $1,200 gadget answers the call—as long as you have the dough

MOTOROLA Q

Thin is in, even for business-oriented devices that fetch e-mail and other files from behind the corporate firewall. A 1.3-megapixel camera and media player ensure that this device isn't all work and no play. Battery life remains an issue.

NOKIA N95

It's a GPS device, 5-megapixel digital camera, digital music player, and Web-connected handheld. What does Nokia call it? A multimedia computer. The N95 is aimed at restoring some of Nokia's lost luster in the influential youth demographic.

SONY MYLO

Mylo means "my life online." Sony thinks this Wi-Fi device will appeal to students. Users can stay connected via instant messaging, Web browsing, and voice-over-Internet calls—and never see a cellular bill.

andards. That makes it easier to roll out ap-ications involving text, voice, music, and deo and have them work seamlessly with any vice, whether it's the slim Motorola Razr or msung's Q1 Ultra Mobile PC.

South Korea and Japan have emerged as or-les of mobility. More than 3 million Koreans gularly use their mobile phones to log on to e giant Cyworld social networking site. Both pan and Korea are starting to roll out speedy iMAX data networks that can deliver wireless oadband access to entire cities. The two coun-es were among the first to initiate walletless yments like Park Hyun-a's graceful phone ipe at the turnstile. That's being tested now the New York City subway and on San Fran-sco's Bay Area Rapid Transit network, as well at McDonald's and in some grocery stores. atching Korea and Japan "is like looking into rystal ball" to see where the U.S. is headed, ys David Meredith, senior vice-president of curity company VeriSign Inc., whose technol-y helps protect such payments.

Much of the credit for these shifts goes to the "Thumb Generation," the twenty- and thirtysomethings who grew up with game controllers and cell phones glued to their hands. People like Park think nothing spending $100 a month for phone-based ser-es ranging from talk and instant messaging mobile satellite TV, games, and e-books.

Not surprisingly, the Thumb Generation is o dreaming up some of the most interesting media-junkie mobile applications. "They don't ask why something can't be done; they simply figure out how to do it," says Ken Hyers, an analyst at industry watcher ABI Research.

Entrepreneur Sam Altman is all thumbs—in a good sense. Instead of spending his 2005 summer traveling abroad, the 21-year-old Stanford University computer science major holed up in a sublet in Cambridge, Mass., writing code to create the friend-finding service Loopt. It aims to address the most common question in text messaging: Where R U? "There's nothing worse than trying to meet a friend, and you don't know how to get to them," he says.

Loopt is a $2.99-a-month service available through youth-oriented wireless carrier Boost Mobile in 41 states and parts of Mexico. It combines mapping software with global-positioning technology and proprietary code to send out alerts when a friend in your opt-in personal network is nearby. With Loopt, you also can view photo diaries of your friends' lives, "chirp" them with the push-to-talk feature on certain phones, and display maps that show where your friends have gathered.

Nobody expects a seamless transition to this new wireless world. Even in areas where there is plenty of venture funding, such as cashless payments and mobile TV, two startups will probably fail for each one that succeeds. More than a dozen companies already offer social mapping software similar to Loopt, and there's a good chance Google, Microsoft, or Yahoo! could trump such services with their own ad-supported deals.

Features, however cool, may not always win fans. Wireless carriers expected digital cam-

Your favorite café "sniffs" your handset as you walk by and tells you if a table is available

BusinessWeek.com

Phonemakers would love to replace the name "cell phone" with something sexier. Offer up your own suggestions, and check out our slide show and Q&A on the latest gadgets, at businessweek.com/extras.

eras on phones to boost their data revenues as consumers e-mailed millions of pictures to one another. But in the five years since Nokia Corp. introduced camera phones, most pictures snapped by Americans remain in the phones' memory. On the upside, U.S. carriers were surprised by how readily Americans paid $2.99 for personalized ringtones. (Sometimes expectations are dead on: Everyone thought NTT DoCoMo Inc.'s Hello Kitty paraphernalia, heavily downloaded in Asia, would fail in the U.S., and they were right.)

The next big battleground could be your back pocket. Studies show that people notice their cell phone is missing within an hour of losing it, compared with a day or more for credit cards and wallets. Such insights helped persuade MasterCard, Visa, and American Express that phones are central to people's lives and actually could start to replace wallets. The Big Three are working with handset makers and service providers to add low-power chips for two-way communication between handhelds and payment systems, on the model of Seoul's electronic turnstiles.

One novel idea: Let visitors in a shop download and pay for a music video simply by waving their phones in front of a poster of a band. Some 450 million handsets with this sort of technology built in are expected to ship by 2011 in the U.S. It would open up a "micropayment" market that could be worth $1.3 trillion. In Japan, contactless payments will total $900 million this year, according to researcher Strategy Analytics. MasterCard and Visa researchers found that consumers whip out the contactless device 18% more often than debit or credit cards, and they spend more per transaction.

Many tech investors are also betting mobile video will eventually catch on. When Paul Scanlan and a partner founded MobiTV in 1999, they had just $500,000 in venture funding. By 2001 their service offered 12 channels of video. Today they have $100 million in backing and stream XM Satellite Radio, along with premium HBO shows and other fare, to handsets. Last year, MobiTV began distributing video for Sprint-Nextel, Cingular Wireless, Orange, and a dozen other carriers worldwide.

Carriers have an urgent need to make these new services stick. While Americans still gab at a rate of 67 billion minutes a month, call revenues have declined sharply because of fierce competition. And as more devices tap into cheap or free Internet calling systems such as Skype, revenues from voice calls could take another hit.

The carriers may well make up for some of that lost revenue by selling episodes of *Lost*. But

Paul Scanlan

At age 29, with just $500,000 in venture capital, Scanlan and a partner founded MobiTV in 1999. Their plan: to stream TV shows to mobile phones. Today the company has amassed $100 million in funding and is distributing premium HBO shows and other fare for Cingular Wireless, Rogers Wireless in Canada, and Orange in Europe.

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Shoppers spend more money when they pay with "contactless devices"

as wireless networks become more congested with data-heavy applications such as video, it's a challenge to provide good service consistently. "Whoever can execute most quickly and most effectively is the guy who's going to lead the horse race," says Bill Clift, a former Cingular chief technology officer who now runs wireless consulting firm Optimi Corp.

New technology may clear some of the bottlenecks. High-speed data networks finally are delivering Web connections to the cell phone with speeds that rival DSL at home. This could lead to a virtuous circle: As network speeds improve, the Gang of Five handset manufacturers—Nokia, Motorola, Samsung, Sony Ericsson, and LG—take a risk and build higher-end digital cameras, music players, and recording devices into their handsets knowing that consumers will find it easier to share content from their phones. That's already happening. At the same time, the handset makers are adding chips that not only help you figure out where you are but also allow others to find you and possibly sell something to you.

Does anybody really want that? Nokia believes its users will welcome such services. Two years ago the company scrutinized 6 billion data points from customer surveys, then embarked on a major push to create do-it-all multimedia phones under the Nseries brand. "If we don't embrace multimedia, enterprise, and the Internet, we will get left behind," says Nokia Chief Technology Officer Tero Ojanper

Two clever technologies may be crucial putting the mobile device on equal footi with the PC. The first is WiMAX. A global sta dard, it is designed to blanket whole cities broadband and could be available to as ma as 1.5 billion users worldwide by 2008. Int Motorola, and Samsung have invested heavi in the technology, and Sprint plans to beg building an entire Web-based phone netwo tuned to WiMAX starting next year. "Everybo is now serious about it," says Intel Corp. Exec tive Vice-President Sean M. Maloney.

Even more intriguing is a next-gener tion networking architecture call IMS, or IP Multimedia Subsyste The technology would essential link up all appliances and electron devices over the Net. Each one th becomes its own Internet "nod able to interact with all the others. Early a plications might include cellular handsets th provide ultrafast Wi-Fi access when you're home, then switch automatically to cellul frequency when you are out of range. Start Mavenir in Richardson, Tex., hopes to take th idea a step further, providing software to ce lular carriers so they could serve up everythi from Internet phone calls to TV shows. So you're out of the house during the big Mich

Great Enablers

Reality is finally catching up with hype in the world of cell phones and mobile commerce. These technologies will usher in the next wave of must-have gadgets and services.

	WIMAX	FUEL CELL BATTERIES	OLED SCREENS	NEAR-FIELD COMMUNICATIONS
WHAT IS IT?	Wi-Fi writ large. This broadband wireless technology can blanket whole cities. It lets you surf the Web at cable speeds, even on the road.	Tiny batteries that run on replaceable methanol cartridges. They'll be sold by Gillette/Duracell at retail and used in mobile phones and other portable devices.	Organic light-emitting diodes, the likely successor to liquid-crystal displays. Unlike LCDs, the diodes light up when you apply a charge, so there's no need for a backlight.	Short-range wireless technology for transmitting data between cell phones an other devices. Nokia, Sony, and Philips see it as a step up from Bluetooth wireless.
WHY IT'S IMPORTANT	Backed by Intel, Motorola, Samsung, and other tech giants, WiMAX could go head-to-head with "third-generation" cellular technology that's rolling out right now.	Mobile data applications drain battery life quickly, and traditional lithium-ion batteries aren't keeping pace with rising power demands. Each methanol cartridge could last several weeks.	OLEDs are thinner than LCDs and consume less power. That matters because screens are the priciest, most power-hungry component in many mobile devices.	NFC chips open the door for an endless range of mobile commerce applications, such as swiping your phone to pay a train fare or sending music or cash to another mobile-phone user standing nearby.
WHEN IT'S DUE	Sprint plans to begin building a nationwide WiMAX network next year, joining cellular pioneer Craig McCaw's Clearwire and others.	MTI Micro Fuel Cells delivered a working prototype to Samsung in early November. The batteries could be on the market in late 2007.	Some handheld gadgets already use OLED screens, and manufacturers are ramping up production.	It has already arrived in Korea and Japan, and McDonald's, Visa, and MasterCard are testing it in the U.S.

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Chris Johnson, Founder & CEO, Priasoft

Chris could always see beyond the garage where he started his software company. American Express could see beyond it, too. They gave him the financing and payment flexibility he needed before anyone else would. How long did it take his bank to realize he had a good idea? "Two years and two weeks too long," says Chris.

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n-Ohio State game, you can tap into ur TiVo from your cell phone, then itch to the big screen—right where you t off—when you get home. This has ge implications for mobility. "A PC is e a telescope into the virtual world," ys Kiyoyuki Tsujimura, NTT DoCoMo's ecutive vice-president of products and rvices. "But with a cell phone, there's merging of the real world and cyber-ace, the physical and the virtual."

Consumers generally agree that do-everything gadgets deliver on their promise, but at a big cost. Battery life tends to be so miserable that users end up having to carry separate devices with dedicated functions, such as playing music. Of the 125 million people who own super-versatile smart phones today, 75% still use one or more of these other portable gizmos, according to researcher In-Stat.

Part of the problem is reconciling

Where Opportunity is Knocking for Small Business

BY DAWN KOPECKI

Forget Silicon Valley. If you run a small business specializing in network technology, Washington D.C. is the place to be. The federal government is gearing up for a massive overhaul of its computer and telecommunications infrastructure by mid-2008, and tens of billions of dollars in contracts are earmarked for small and minority-owned businesses.

The government is upgrading its equipment in order to increase security and comply with a powerful network standard known as Internet Protocol version 6, or IPv6. Washington has no choice: Without the upgrade, which is now under way in many countries, the world will exhaust its supply of Internet addresses sometime in the next five years. But many side benefits will also flow from the overhaul. The new Internet standard is designed for speed and will result in communications systems that are sturdier, more stable, and harder for hackers to attack.

> Washington is spending billions to upgrade computer and telecom infrastructure

To pull off this upgrade, the government will need a lot of help from companies that supply info-tech services, including hardware installation, computer programming, and personnel training. That plays to the strengths of startups such as Command Information in Herndon, Va., founded late last year by entrepreneur Tom Patterson, with $15 million in backing from The Carlyle Group. In transitions like this, says Charles O. Rossotti, a former IRS commissioner who now works for the giant private equity firm, "there are always opportunities for people providing services and support."

It was a smart move for Patterson and his backers. Federal purchasers proposed a rule requiring all civilian and Defense Dept. agencies to upgrade their technology infrastructure—PCs, routers, switches and software—to IPv6 within the next 20 months. As part of the transition, the General Services Administration, which buys IT services for dozens of other federal agencies, put out for bid two massive IT contracts to upgrade phone systems and IT infrastructure. The contracts include two of the largest federal set-asides for small, minority, and disadvantaged businesses ever, a total of $35 billion.

Hardware and network services needed for the changeover will be purchased through a new 10-year, $68 billion contract, Networx, that reserves up to $20 billion for small and minority-owned businesses. AT&T, Sprint, and other telecom giants are vying for a $48 billion portion of Networx. Whoever wins will farm a lot of the work out to small subcontractors. And next summer a separate contract, called Alliant, will steer an additional $15 billion to small outfits.

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HOW AMERICAN EXPRESS SERVES SMALL BUSINESS

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Noah Glass

Yes, there may be a coffee shop on every corner in New York. But 25-year-old Noah Glass thinks the breakfast and lunch lines are way too long. So he invented Mobo, a service that stores your credit-card data and favorite takeout orders on its server. Need coffee and a croissant? You send Mobo a text message, the computer places the order, and the restaurant of your choice starts putting it together. The food is waiting and the bill paid by the time you reach Mobo's express counter.

function and fashion. Members of the Thumb Generation see their phones and music players as extensions of their personalities. That's why so many of them demand stylish phones like Motorola's Razr. Rivals blasted it when it debuted because of its poor battery life and confusing user interface, but it has sold more than 50 million units in just two years on the market, nearly as many as the iPod. Nokia, Samsung, and even Research in Motion, maker of the BlackBerry, have responded with devices like the e61, BlackJack, and Pearl, respectively, which are also battery-challenged if users try to move around too much data in the form of TV shows or music. "The mobile phone can either be like a Swiss Army knife or a Swiss watch," laments Scott McGregor, CEO of wireless chip provider Broadcom. "One does a lot of things, none of them particularly well, and the other operates with perfect precision."

Like automakers, handset manufacturers are turning to alternative energy sources to solve the ubiquitous battery problem. Samsung this fall received a methanol-based battery prototype from fuel-cell maker MTI Micro. It hopes to commercialize that in late 2007, replacing its traditional lithium-ion batteries. Consumers would buy replacement cartridges made by Gillette/Duracell to get battery life sometimes measured in weeks instead of hours. Toshiba, Hitachi, Fujitsu, and other battery makers also are pursuing the technology.

Once the technical issues are fixed, the rollout of such technologies could disrupt the business model of both gadget-makers and content providers. This process can be pe plexing to consumers. Microsoft new Zune digital music playe for example, ostensibly does th same thing as an iPod, but it selling point is that it shares ir formation over a wireless linl Apple reportedly plans to respon next year by selling a phone th also plays music. Do you call it phone, a music player, or an iPod It's a muddle. Nokia now calls i Nseries of smart phones "mult media computers." Samsung ha settled on the term "mobile ir formation terminal" for its mo phone-like products, but device not much larger are referred to a "ultramobile PCs."

Figuring out who gets pai for which part of the business almost as dicey as deciding wh to call the different elements. Co sider what happens when *Amer can Idol* viewers pay 99¢ to cast vote for their favorite singer v text message. Proceeds that can amount to mi lions of dollars are split between the network, th show, and Cingular. If you watch the show c your cell, MobiTV also takes a cut.

With so many partners in on each transactio the stage seems to be set for consolidation. A ye ago, Sprint partnered with Comcast, Time-Wa ner, and other major cable players that would a low each to resell a combined wireless and conte package. Some speculate Comcast may eventual be forced to buy Sprint-Nextel to compete wi Verizon Communications, which is rapidly buil ing a fiber-optic network to complement its trac tional wired and wireless businesses.

Chaotic, to be sure. Yet this is the futu 25-year-old Noah Glass relishes. After all, h generation says it no longer wants to fumble f cash, and it trusts the Web enough to handle tas like preordering and prepaying for Subway san wiches. Glass's startup, Mobo, allows its membe to store their credit-card information, favor restaurants, and typical menus on a comput server. Each order has its own number. As y head to work in the morning, you text just o of those digits to Mobo, which places the ord and pays the bill. The restaurant then texts ba to tell you when your order will be ready. Arrivi at the restaurant, you skip the line and pick your breakfast at Mobo's express counter. Mo charges you nothing but gets 10% of each ord from the vendor.

Glass sees no reason Mobo can't extend t model to ticket ordering, parking-meter p ments, and taxi services. "We want to make Mo a verb, as in 'I just Mobo'd my lunch,'" Glass sa Looking back in a few years, maybe we'll disco that we have all just mobiled our whole lives. ■

–With Kenji H

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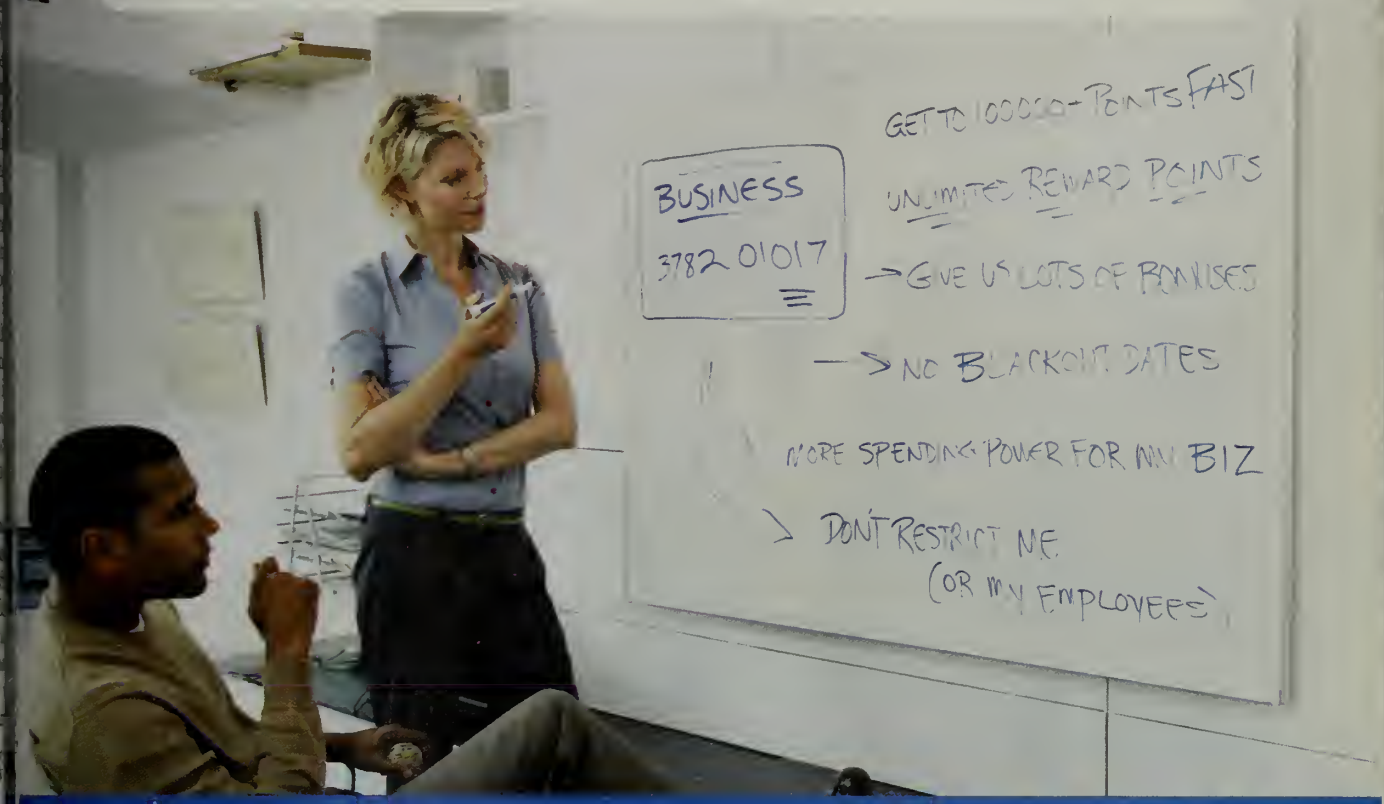

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Flight Plan

Inside Gerald Grinstein's struggle to save Delta By Dean Foust

DELTA AIR LINES INC.'S CHIEF OPERATING officer, Jim Whitehurst, was in a hotel in Orlando, on his way to a workout before a speech to 500 of the carrier's sales reps, when he heard the news on TV. Chief Financial Officer Edward Bastian, was driving to work when he saw the headline on his BlackBerry at 7 a.m. And Delta CEO Gerald Grinstein was slipping on his tie and preparing to head in to the office when a voice on one of Atlanta's AM stations urgently announced that US Airways Group was making a hostile $8.8 billion bid to buy Delta out of bankruptcy.

In many ways, the bid couldn't have come as a huge surprise to Delta's management team. As soon as Grinstein & Co. put the airline into Chapter 11 in September, 2005, managers knew that the long-anticipated wave of consolidation among the nation's largest airlines might finally be at hand and tha Delta would be a juicy target. It dominated the nation's se ond-busiest airport, Atlanta. And Delta would still be mire in bankruptcy long after other airlines had emerged and wer reporting strong profits. Even before the $16 billion carrier ha filed for bankruptcy, United Airlines CEO Glenn F. Tilton ha called Grinstein expressing interest in Delta but was rebuffe on the spot. "He said, 'Are you interested in talking?' And I sai 'Not at all,'" recalls Grinstein, a crusty but charming lawyer an former railroad executive. He had already rejected two overtur from Doug Parker, the brash young chairman of US Airway who had proved his mettle dealing with some of the same cha lenges facing Delta, such as fighting off low-cost carriers an streamlining poorly performing hubs.

When Parker countered with a hostile public bid on Nov. 1 a new act unfolded in the drama that has consumed Grinstei

636

> "We will not concede an inch of ground to AirTran ever again. This is our town. We'll take it back." —DELTA COO JIM WHITEHURST

and his two lieutenants for the past year. On a personal level, having to sell Delta would be a bittersweet denouement for the trio. For Grinstein, Bastian, and Whitehurst, bankruptcy has been a tortuous process in which they, in effect, killed off the old company as they tried to raise a new Delta from the ashes. Bastian still vividly remembers standing in the bankruptcy court the day Delta filed. "There must have been 200 people in the courtroom," he told a large gathering of employees in September. "And I was the only person there from the company among layers of accountants, lawyers, all eyeing what they were going to take from Delta—an arm, a leg."

Yet for all the agony of bankruptcy, Bastian told the same employees that it was exactly the medicine Delta desperately needed. "Bankruptcy allows you to bury the past and examine every decision this company has ever made," he said. And in the past year, Grinstein, Bastian, and Whitehurst have worked around the clock renegotiating thousands of contracts, bucking up demoralized employees, imploring bankers to provide financing, and wrangling with creditors to keep them from picking all the meat off Delta's bones.

If Grinstein and his team are to preserve Delta's independence, they now must persuade those very same creditors—a diverse group that includes Boeing Co., the Pension Benefit Guaranty Corp., and even its own pilots' union—to reject US Airways' proposal and to place a bet that management's ongoing turnaround efforts will deliver a bigger long-term payback. Perhaps anticipating that US Airways or another carrier might resurface with a bid, Bastian had begun in recent weeks privately making the case to Delta's creditors that the airline would be worth far more as an independent carrier than whatever sum any suitor who came along might be willing to pay in bankruptcy. "They're going to be much richer than they think," says Bastian.

Indeed, Grinstein, a longtime director who came out of retirement two years ago at age 71, has made clear that h doesn't want to see the airline devoured by an upstart carrie out of Arizona. A merger "would just slow down our eme gence from bankruptcy. And the track record for mergers just not great," he said in an interview right before us Airway made its bid. Some creditors who spoke to *BusinessWeek* sa that it isn't a given that they'll push for US Airways' bid, whic offers bondholders a 25% premium to the recent trading valu of Delta's unsecured debt. But they warn that the recent off raises the pressure on Grinstein and team to make a persuasiv case that they can wring more profit out of Delta than US Ai ways can—and do it fast. "I don't think the Creditors' Commi tee is necessarily going to say, 'The US Air deal is great. Let go,' " says a source close to one creditor. "But they will use it put Delta's management into a bidding contest."

IF US AIRWAYS' PARKER ULTIMATELY SUCCEED he'll be capitalizing on the hard work of Grinstein, as well as the ingenuity of Bastian, a former Delta exec tive who returned last year to help revive the carri and Whitehurst, a former Boston Consulting Grou Inc. whiz kid who has shot up through the ranks his five years at Delta. In the past year, the carrier h engineered a sweeping overhaul of its vast network—cuttin as much as 20% of its domestic capacity, shifting many of i biggest jets to serve burgeoning international business cente like Bucharest and Düsseldorf, and all while trying to repla its hidebound, genteel, Southern culture with a more aggre sive one.

Since 2003, Delta's head count has shrunk from 70,600 51,000, while the number of airplanes is down from 833 625. Perhaps most important, Delta has slashed its costs fro 9.36¢ per seat mile (before fuel expenses) in 2003, the wo

HOW DELTA IS CHANGING

	REVENUES	EMPLOYEES	FLEET	TOP PILOT PAY	CULTURE	ROUTE STRUCTURE	COSTS
Old Delta 2003	$13 billion	70,600	833 planes	$256 per flight hour (for 757 pilot)	Bureaucratic, top-down management. Employees informed on a "need-to-know" basis	80% domestic, 20% int'l	9.36¢ per seat mile (highest of nine major carriers)
New Delta 2006	$16 billion*	51,000	625 planes	$155 per flight hour (for 757 pilot)	More entrepreneurial; workers empowered to make on-the-spot decisions	65% domestic, 35% int'l	6.91¢ per seat mile (fourth-lowest of major carriers)**

*Estimate **Excluding fuel **Sources:** Company, *BusinessWeek*, Calyon Secu

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"I thought Delta valuable, worth saving. I thought I could repair some of the damage between leadership and the people who deliver the service." —CEO Gerry Grinstein

among the nine major carriers, to 6.91¢ per seat mile this year, the fourth-best in its peer group—and the best of the so-called network carriers like United, American Airlines, and even US Airways. "We're coming out a different company from how we went in," says Mike Campbell, Delta's executive vice-president for human resources and labor relations. Contrasting Delta's experience in bankruptcy court with United's, he adds: "I don't know that United changed the business at all. They [just] changed the balance sheet."

Delta managers have been making anxious jokes about a potential takeover bid for months. Their angst was evident during a companywide therapy session in late September. Hundreds of Delta workers filtered into a conference hall in downtown Atlanta—as the sounds of rock band Journey's song *Lovin', Touchin', Squeezin'* filled the air—to hear Bastian and Whitehurst offer a state-of-the-company address. As a warmup, a pair of employees posing as TV newscasters cracked jokes: "Remember medical benefits? Weren't those great?" (For the record, Delta still provides medical benefits.) Then Grinstein spoke in a video discussing Delta's precarious condition, his face superimposed over Tom Cruise's body as he hung by his fingernails from a cliff. The crowd whooped.

BUT, THE EXECS WARNED, DELTA STILL HAD much work to do to turn the airship around. "We're going through a massive amount of change, and change is hard," said Bastien.

To understand Delta's current predicament requires a little history. After archrival Eastern Air Lines imploded in 1991, Delta found itself with a near-monopoly in the Southeast. Over the next decade, it practically coined money, earning far higher profit margins than any other airline. Supremely confident of Delta's ability to fill seats, management began using giant Boeing 767s and 777s for short flights—Orlando to Atlanta, for instance—decisions that eventually forced the carrier to offer cut-rate fares just to fill the planes. "[Former] Delta management never met a big plane they didn't want to buy," laments one current Delta executive.

By 2004, with Delta already having hemorrhaged more than $3 billion, it was painfully clear the airline needed its pilots to make concessions. And when then-CEO Leo Mullin failed to bring the pilots back to the table, Delta's directors quickly coaxed Grinstein, a fellow board member who had deftly handled contentious union negotiations as CEO of Western Airlines and, later, Burlington Northern Railroad, to take the job. "I thought Delta was valuable, worth saving," Grinstein says. "I thought I could repair some of the damage between leadership and the people who deliver the service every day." He succeeded: With their peers at other airlines offering pay concessions of their own, the pilots agreed that November to swallow a 32% pay cut.

That was not enough, however, to keep Delta from filin Chapter 11. From the moment that Grinstein put Delta int bankruptcy last year, he knew he was racing against th clock to save the airline. And Grinstein and his lieutenan now confess that as recently as late last year, he wasn't su whether Delta would survive—or if it would join the likes Braniff International Ai ways, Eastern, and Pa Am in the long line casualties since the airlir industry was deregulate in 1978. "When Gerry, E and I sat down and ran th numbers, we were scare to death about whether would make it through th winter," Whitehurst no recalls. "We were lookir at running out of cash."

Grinstein: The record for airline mergers "is just not great"

The team got the finan ing it needed to surviv But then it had to take an even harder probler repairing relations wi Delta's workforce. One Grinstein's first tasks w to rebuild morale in D ta's ranks—in part by a mitting that Delta's pro lems were caused large by past management mistakes. To do that, Grinstein and team have spent the past year flying across the country wi the goal of speaking to all of Delta's 51,000 employees.

But the wounds have been slow to heal. As Whitehu strode to the front of a dim, windowless room at the Atlar airport, there was no applause—not one clap—from the 20 so veteran pilots who had gathered on a steamy July mor ing to hear the boyish-looking executive's plans for fixing t bankrupt airline. With mock seriousness, Whitehurst ticked the litany of excuses that his predecessors had cited to expla the Atlanta carrier's downward spiral: high fuel costs, s competition from rivals like AirTran Airways Inc., rich pensi obligations, and—yes—high labor costs. Whitehurst paus then said, "Let's be honest. That's bull----. We are in bar ruptcy because we have been losing in the marketplace."

But Whitehurst's efforts to extend an olive branch did lit to win over the assembled pilots. One pilot, a 15-year emplo of the embattled carrier, quickly put Whitehurst on the sp "Since 1991, I've watched every CEO of this company have inbred hatred of the pilots. Do you have an inbred hatred us?" Whitehurst paused, choosing his words carefully. " have lost a lot of trust," he conceded to the pilots. "We hav long way to go."

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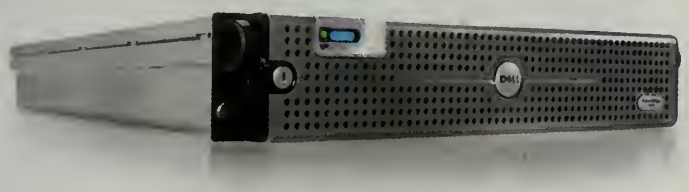

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> "We were scared to death about whether we would make it through the winter.... We were looking at running out of cash." —JIM WHITEHURST

Regaining the trust of employees first meant blowing up the old Delta culture, a top-down structure where employees felt stifled, and creating a new regime where workers felt empowered. To exorcise the "old Delta," Grinstein, Bastian, and Whitehurst spent the past year criss-crossing the country to hold "town hall" meetings where employees could vent and ask questions. On top of that, Delta flew in more than 17,000 top workers—500 at a time—into Atlanta for special daylong sessions staged in a vacant Macy's building downtown.

Following the video from Grinstein and a talk from either Bastian or Whitehurst, workers broke into smaller groups of 40 or so and were led through an exercise where they were asked to draw up long lists describing the "Old Delta" and the "New Delta" they hoped to see. At one session in late September, the assembled workers took a certain relish in mocking the Old Delta. "Procrastinate!" shouted one worker, as the others tittered. "Yeah, the phrase I always heard was, 'If you don't do it, you can't get in trouble,'" nodded another. "Hey, here's the Delta Coat of Arms!" said a third, crossing his arms and pointing in opposite directions, a gesture that won howls of laughter.

Rebuilding morale was only the start. Grinstein's next task was rebuilding Delta's management ranks, which were depleted because many of Mullin's hires opted to take their pensions and run in anticipation of the airline's bankruptcy. In July of last year, Grinstein began assembling the team that is in place today. First, he lured back Bastian, who had served as controller before leaving just a month earlier, to return as chief financial officer. Then he promoted Whitehurst, a former Delta consultant whom Mullin hired on the spot as acting treasurer on the morning of September 11, 2001. After rushing the paperwork through, Whitehurst began working for Delta that same day—even though it initially meant taking an 80% pay cut from the $1 million plus he earned his last year at the Boston Consulting Group (though he will assuredly receive valuable stock options when Delta emerges from bankruptcy).

The brainy Whitehurst, a self-described "redneck" from the sleepy south Georgia town of Columbus, has brought a certain feistiness that never existed at the airline before. Indeed, the same company that once opted not to match AirTran's low fares has now adopted a more aggressive approach again competitors. Partly to tamper with the on-time performan of rival JetBlue Airways Corp., Whitehurst added slow Dash-8 turboprop planes at LaGuardia Airport in New Yo to time slots just ahead of JetBlue planes. And last Februa when AirTran announced it would begin offering Atlanta-t Seattle service—a route that Delta has long had a lock on—t Atlanta carrier said it would fly regional jets on six AirTr routes from Orlando, AirTran's headquarters city. "We will n concede an inch of ground to AirTran ever again," Whitehu

Whitehurst: Spearheading Delta's new feistiness

Bastian: Slashing costs to revive profits

told the gathering of Delta pilots in July. "This is our town. will take it back."

Grinstein's biggest challenge on the management front w to find the talent to restructure Delta's jumbled domestic n work, which by every measure was one of the most inefficient the industry: The airline, for instance, offered five daily fligh between Salt Lake City and Butte, Mont., even though no m than 110 people traveled that route each day. As Grinstein c about for candidates, he spotted a story in an airline tra publication about Glen W. Hauenstein, a gregarious form Continental Airlines scheduler who was then serving as ch operating officer of Alitalia, the Italian state-controlled airli

Grinstein picked up the phone and talked to a few industry friends, including Gordon Bethune, the reti CEO of Continental. "I told Jerry that Glen was as good as t came," recalls Bethune. "Jerry said, 'But Gordon, we're bro

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"We ran the [merger] numbers.... The [notion] that this could survive DOJ is beyond comprehension." —DELTA EXECUTIVE

on't think I can afford to hire him.' I said 'Jerry, you can't ord not to hire Glen. He'll make you $30 million in his st 30 days.' "

Hauenstein went to work, first scaling back and streaming the airline's money-losing Cincinnati hub, which th more than 600 daily flights was sending up too many lf-empty planes. "A year ago it was our worst-performing b. Today it's one of the best," Bastian said at an employee eeting in October. He also redeployed the widebody jets ed in Delta's trendy Song subsidiary, fitted out with digital tertainment at each seat, to be used on transcontinental ites, hoping that all those music and movie offerings will ract customers in need of diversions on the five-to-seven-ur flights.

AND TO BUILD DELTA'S PALTRY INTERNAtional service—when Hauenstein joined, the carrier derived a paltry 20% of its revenues from international flights, vs. 36% for United and 43% for Continental—he pulled a page from his old Continental game plan and began expanding into second-tier cities where e competition isn't as fierce. He added direct service to tour- destinations like Nice, France, and rolled the dice with new ites to some heretofore obscure destinations like Accra, the anian capital that has seen its fortunes pick up with an in-ase in oil exploration.

But some rivals are skeptical that Delta's aggressive intertional expansion will work. Among the critics: Continental esident Jeff Smisek, who panned Delta's global ambitions at ear Stearns Companies Inc. conference last May. "They are owing a lot of capacity into the market. I predict they will e their shirts on it," he told the gathered investors.

Delta executives challenge these criticisms. While traffic Nice has been a little slower than anticipated, they still lieve there's untapped potential to and from blossom- global markets like Bucharest. Delta executives says a key has been Hauenstein's ability to tweak the airline's mestic flight schedule to feed more passengers into these w international routes. Take Kiev, a market to which lta now flies five times a week. Not only is Delta filling ts with Ukrainian immigrants who live in New York's roughs, but Grinstein points out that the new feeder ghts Hauenstein set up from Seattle are bringing in an av-ge of 35 additional customers a day for each Kiev flight. eattle's my home, but I had no idea there was a Ukrainian pulation there," marvels Grinstein.

Ironically, Delta's international routes may be one of the ngs that make the bankrupt carrier so attractive to US Air-ys, which has a much smaller footprint overseas. Whether Airways will prevail or Delta preserves its independence is uestion that will be answered in coming weeks. Some ana-

Delta scaled back and streamlined an unwieldy mix of domestic flights, and expanded into second-tier cities abroad

lysts think Delta's creditors could put a lot of pressure on Grinstein & Co. to accept Parker's offer. But even if that happens, Delta executives privately doubt that US Airways can get the deal approved by the Justice Dept., given the immense overlap between Delta's domestic routes and those of US Airways. "We ran the numbers and the only deal that would [hypothetically] create more overlap than this one would be American and United," confides one Delta exec. "The [notion] that this could survive DOJ is beyond comprehension."

For their part, US Airways' officials say they are confident the deal would receive regulatory approval. If they're right, the combination of Delta and US Airways, which Parker says would carry the Delta name, would create the largest carrier in the nation, and, in time, potentially one of the more profitable. That would mean that Grinstein and team will have succeeded in their task of returning Delta to its old glory as one of the most profitable airlines—but in a way that they certainly never intended. ■

Duane Reade: An LBO On the Critical List

Its three-year debt binge turned the drug chain from gem to junk

BY DAVID HENRY

BACK WHEN THE LEVeraged-buyout boom was warming up three years ago, shareholders of Duane Reade Inc., the 249-store pharmacy chain based in New York, were complaining that private equity firm Oak Hill Capital Partners got too sweet a deal when it paid $750 million to buy the company.

Now it looks as if Oak Hill is turning out to be the loser, by as much as $240 million. Duane Reade has hemorrhaged cash from virtually the day the transaction closed in July, 2004. Oak Hill replaced the CEO after just 17 months. And the chain has seen its credit rating downgraded four times by Standard & Poor's. It now stands at CCC, a level so deep into junk territory that it puts 1 in 4 odds on Duane Reade defaulting within a year. A spokesman for Oak Hill declined to comment.

Whether or not the deal winds up a bust, it warns of trouble to come for other recent LBOs, mostly because of its timing. Corporate bond investors call the pattern "seasoning." As deals reach three years of age or so, it becomes clear whether the companies will be able to generate enough cash to service all the debt they took on to go private. According to Thomson Financial, the current wave of LBOs started three years ago this quarter, when private equity firms announced 177 buyouts worth $18 billion. The volume has continued to build since: In the recent quarter ended in September, 313 deals were struck worth $80 billion.

Duane Reade's experience shows how quickly companies can find themselves in trouble after taking on lots of debt. The once-thriving retailer is slumping in nearly every way. Analysts say shoppers consider its 130-odd Manhattan stores convenient, yet cluttered and crowded, places they go to but don't like. And the stores are no longer known for the discounts that attracted people a decade ago. "They lost their core customer," says Diane Shand, an S&P credit analyst.

Behind the scenes, Duane Reade has blundered. It has fought costly battles with labor unions, made poor merchandise choices, failed to deter rampan pilfering, and made no headway in ex panding in the suburbs, where customer prefer CVS Corp., an investment-grad company with 25 times Duane Reade' $1.6 billion in revenues.

Outside forces are battering Duan Reade, too. Profit margins on drugs ar plunging as mail-order benefits manag ers proliferate. Minimum-wage hikes i New York have raised labor costs. An the explosion of digital cameras has lure away film-processing customers.

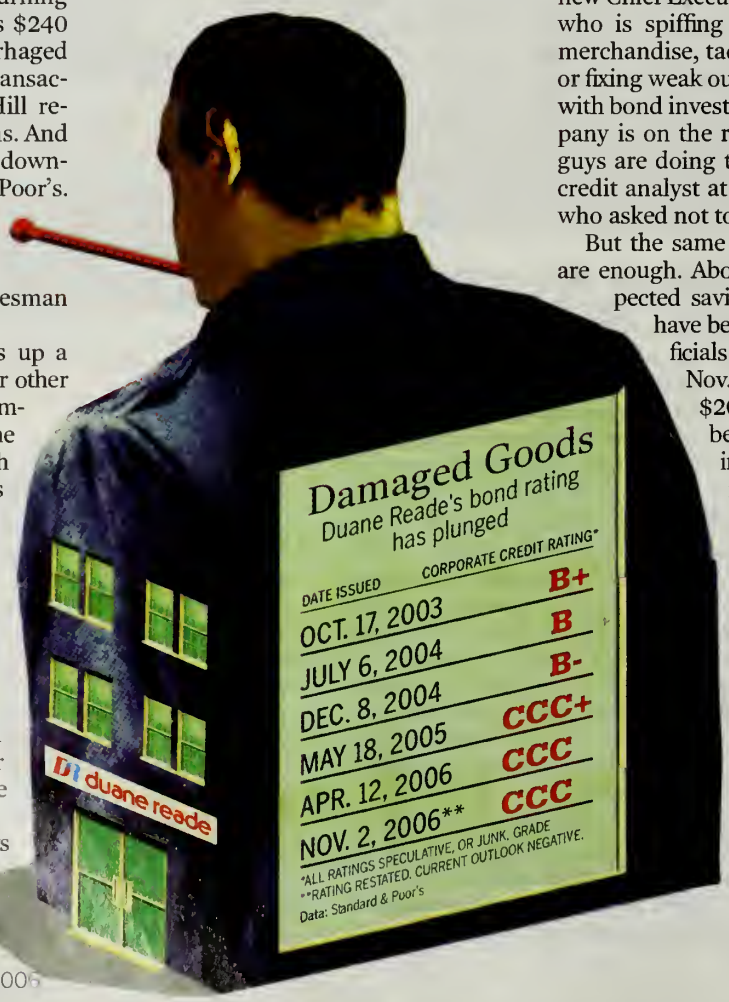
All this would be easier to deal wit if Oak Hill had not nearly doubled th company's borrowings, to $500 millior to finance the buyout. Duane Reade need to offer good product selection but has cu inventory to save cash. Its dire financia straits, say analysts, are forcing the chai to consider trading its best locations fo cheaper ones. Relationships with suppli ers hinge on how long a $225 million lin of bank credit will last; the company ha already used $170 million.

BURNING CASH

OAK HILL HAS tried to save its invest ment. In November, 2005, it installe new Chief Executive Richard W. Dreiling who is spiffing up stores, overhaulin merchandise, tackling theft, and closin or fixing weak outlets. In conference call with bond investors, he has said the com pany is on the road to recovery. "Thes guys are doing the right things," says credit analyst at a Wall Street brokerag who asked not to be named.

But the same analyst doubts the fixe are enough. About two-thirds of the ex pected savings from the campaig have been realized, company o ficials said in a conference ca Nov. 9. They're still burnin $20 million in cash a yea because of $53 million i interest charges. S&P say its next rating move ma well be downward.

Bond investors be lieve Oak Hill want to sell before industr pressures worsen. Bu it's doubtful the par ners could get enoug money to do more tha cover the debt, if tha analysts say. Duan Reade is starting to loo like a zombie: dea but walking amon the living. Other LBC may soon follow i its footsteps. ■



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Lighting a Fire Under Campbell

How Doug Conant's quiet, cerebral style got things bubbling again

BY ADRIENNE CARTER

THERE ARE high fives all around at the Tweeter Center, a concert venue in Camden, N.J., where 1,400 employees from Campbell Soup Co. are celebrating at the company's annual awards event in late October. Some of the accomplishments read more like those of a fast-growing technology startup than a staid food company. Earnings were up more than 100% in Pepperidge Farm Goldfish last year, thanks to new ads and innovations like the 100-calorie packs. And new products and stores helped propel Godiva Japan to double-digit sales growth.

Amid the revelry, Chief Executive Douglas R. Conant beams like a proud but geeky dad as he sings and dances to the Goldfish jingle. He has plenty of reasons to smile. In just under six years since he came on board, Conant, 55, has transformed Campbell from a beleaguered old brand rumored to be on the auction block to one of the food industry's best performers. The stock is up 100% since March, 2003, more than double other comparable food companies. In the fiscal year ending July, 2006, net income rose 8%, to $766 million, on sales of $7.3 billion. In the latest quarter, although earnings fell on a tax settlement, they still beat expectations. The turnaround has been catalyzed by cost-cutting, smart innovations, and a concerted effort to reinvigorate the workforce. "We're hitting our stride a little bit more [than our peers]," says Conant, in his usual understated style.

Conant's strategy isn't complicated: He just wants to keep up the good work, which will mean coaxing more great ideas from his workers. That is a tall order. Among big branded food companies, Campbell has been something of an outlier in its ability to jump-start sales. Elsewhere, revenue growth has been sluggish. Large, established companies have run into trouble demanding higher prices from consumers, who have more high-quality generic and private-label choices than ever. Plus, three of Campbell's largest competitors, including industry heavyweight Kraft Foods Inc., have appointed new CEOs in the past year, all of whom are itching to put their mark on their businesses.

"I CAN DO BETTER" Conant is no whipcracker, but he's not one to shy from tough decisions

Conant hasn't shaken up a complacent 137-year-old company by being in-your-face. He happily give others credit and deflect praise. He's not bras like his mentor Jim Kilt the former Gillette chie who was Conant's boss a Nabisco. In fact, many co workers have told Conar he wasn't tough enoug to hack it in the bus ness world. In his time a Campbell, he has sent ou more than 16,000 hanc written thank-you note to staffers, from the chie investment officer to th receptionist at headquar ters—notes often foun hanging in people's office or above their desks. "[I business] we're trained t find things that are wron but I try to celebrate what right," says Conant.

A self-described intro vert, the father of thre grown children is mo likely to retreat to th corner of a crowded bal room than engage a grou of strangers. He says h needs regular "alon time," which he gets o his daily commute, fou hours back and forth the northern New Jers empty nest he shares wit his wife, Leigh. Once year, he retreats to plac like the Utah mountains for person reflection.

Unlike many of his peers, Conar knows he doesn't have all the answer admitting mistakes with a simple b meaningful "I can do better." Says Ha vey Golub, Campbell's chairman and th former head of American Express Co "He's an extraordinary leader who b haves with the utmost integrity. Peop follow him and believe in him. He's a Eagle Scout."

A devout reader of leadership tome

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ıant has scores of ks in his office on lves and piled up in ners. He keeps extra ies on hand to share ı colleagues, and started an executive k club for top brass. cerebral Conant ours the words of ryone from Presi- t Abraham Lincoln World War II Gen- George S. Patton to nagement guru Ste- n Covey. He regular- ands out the parent- book *Whole Child, ole Parent*. And he ps Leo Tolstoy quotes conversations. "I'm essed with getting insights," he says. ecently read a book ut Patton, and he an obsessive reader. really the only way earn."

Ie may come off as kish, even Clark t-like in his de- nor, but Conant n't shied away from ing gutsy calls. Over e 30 years, mostly in food business, he's en his hands dirty. r graduating from thwestern's Kellogg ool of Management spending 10 years General Mills Inc., ant worked his way the ranks at Kraft Nabisco. Under s at Nabisco, Conant charged with fixing up the marga- unit for a sale, a job that ultimately uded laying off staff. Later, he helped ve lifeless but iconic brands such Planters nuts and Life Savers candy, only with cost-cutting but also with evamped marketing plan and new duct launches. At Planters he gave gtime pitchman Mr. Peanut a bigger form, and at Life Savers he over- the rollout of Creme Savers. Those es helped drive double-digit sales wth in each business. Both stints ved useful training grounds for his ent fix-it job at Campbell.

n one of his first moves at Campbell, lowered earnings expectations and hed the dividend by 30%. The stock dropped precipitously in his first 18 months on the job. The founding Dorrance family, which owns around 50% of the company's shares, took the hit directly in the pocketbook. Yet the board of directors, which includes several Dorrance family members, was behind Conant, since the cuts gave him money to invest in the future of the business. "He's the guy with an iron fist in a velvet glove," says Kilts.

Conant knows that Campbell must keep restocking its cupboard with new products and ideas to maintain its momentum. So he has focused on innovation, the lifeblood of any consumer packaged-goods company. He has homed in on three key areas: healthy, convenient, and premium goods.

Take soup, for example. It's still Campbell's mainstay, accounting for half of sales. Simple innovations such as pop-top cans helped lift sales of condensed soup 8% in 2005 and 5% in 2006 after more than a decade of declines. In August, the company launched a lower-sodium line that uses natural sea salt. Unlike previous generations of lower-sodium soups, this one has the full flavor of the regular stuff—a sort of holy grail for soupmakers. It's a technology cooked up in Campbell's research labs. Campbell is also testing a new line of refrigerated soups with gourmet flavors, such as crab and sweet corn chowder. The premium flavors come with premium price tags—about $5.50 for 24 oz., compared with about $2.50 for a 19 oz. can of Campbell's Chunky soup.

In supermarkets, Campbell has installed new shelving systems that automatically slide the next red-and-white soup can to the front when shoppers pluck one for their carts. It also sorts different types of soup by typical use; Cream of Mushroom sits in a cooking

The Executive's **Book** Club

The CEO of Campbell is a devout reader of leadership tomes. Here's a peek at Doug Conant's shelf.

GOOD TO GREAT
by Jim Collins

THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE
by Stephen R. Covey

THE SPEED OF TRUST
by Stephen M.R. Covey

LEADERSHIP JAZZ
by Max DePree

AUTHENTIC LEADERSHIP
by Bill George

THE WISDOM OF TEAMS
by Jon R. Katzenbach and Douglas K. Smith

PURPOSE
by Nikos Mourkogiannis

TREASURE HUNT
by Michael J. Silverstein

WHOLE CHILD, WHOLE PARENT
by Polly Berrien Berends

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PLAYBOOK: BEST-PRACTICE IDEAS

The Key Ingredient at Campbell: People

/hen Conant first measured employee engagement with a 12-question Gallup poll, his 'orkforce ranked at the bottom of the barrel. Here's how he reinvigorated it:

SE A PERSONAL OUCH

ɔnant has sent out more than ,000 thank-you notes to affers of all levels since he ecame CEO in January, 2001.

SET EXPECTATIONS

Every manager must meet with direct reports each quarter to update their progress on clearly articulated goals.

OPEN YOURSELF UP TO OPINIONS

Every six weeks, Conant has lunch with a group of a dozen or so employees to hear about problems and get feedback.

CREATE OPPORTUNITIES

Conant encourages movement among staffers and has developed a CEO Institute to bolster the pipeline of talent.

tion, while Chicken & Stars rests next Chicken Alphabet in the kids' section. ɔermarkets are happy, because their ɔppers are buying more soup, and the v shelving system makes restocking easier. "Doug has helped reinvigo- e a category that didn't have a lot of ovation," says Jeffrey Noddle, CEO of nt supermarket chain Supervalu Inc., ich owns Jewel-Osco and Albertsons res, among others.

Campbell's Godiva brand fits more sely into Conant's premium products category than the healthy one. The famous purveyor of gold-boxed chocolates is remodeling its stores to encourage shoppers to stop by regularly, rather than just for special occasions when they need gifts. At in-store "chocolate bars," Godiva sells individual strawberries (chocolate-covered, of course) and Chocolixer, a drink you can get hot or cold.

Conant is also eyeing major markets like Russia and China. In both countries, people eat billions of bowls of soup a year, but nearly all of them are made at home. "The story he's bringing to the table is probably one of the most interesting [in the food business], because he's thinking long-term," says Sanford C. Bernstein & Co. analyst Alexia Howard, who figures Campbell's can grow earnings per share by 8% a year through 2010. "Campbell's has very effectively found consumer insights and turned them into sustainable growth opportunities."

Conant certainly hopes so. As he sees it: "The corporate life is Darwinian, so you either grow or you die." ■

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A Shock to The System

States and cities are now discovering just how staggering their retiree health-care burdens are

PICKETT Retired and worried

BY NANETTE BYRNES

ON NOV. 16, DELOR Campbell heard t words she'd be dreading for montl Seated at the back a packed conferen room in Charleston, Va., she listened carefully as a consulta to the state's Public Employees Insuran Agency outlined a dire scenario. We Virginia is spending $100 million a ye on retiree health-care benefits, he sa and if nothing changes, the tab could l $1 billion a year in just five years. On t of that, the state, which now estimat that it has promised current and futu retirees $8 billion in health care over t next 30 years, could see that figure b loon to $50 billion in 2040. West Virgir has nothing saved against that pled and to lower costs is considering doi away with a program that supplemer Medicare for those over 65. "It loo pretty bad for us," says Campbell, who taught social studies to sixth grad for 38 years before retiring in 2004.

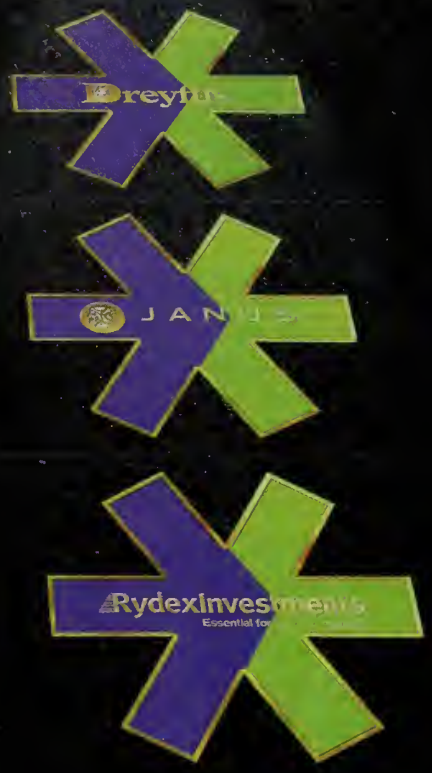
The wrenching choice West Virgir faces is more than an isolated drama. I a harbinger of bad things to come acr the country. A new rule by the Ge ernmental Accounting Standards Boa (GASB) that begins to take effect n month requires states, cities, and sch districts to tally up and disclose the val of the health care they've promised th retirees. Faced with the numbers, gove ments are scrambling to find ways eit to cut back on the cost or raise money start funding it. Many plan to do both

PAINFUL TRADE-OFF

FEW COMPANIES still offer health c to retirees. But governments continue provide it, often to compensate for lov wages. Now that looks like a bad tra off. Health-care inflation has been higher than wage growth, so, as they painfully discovering, public-sector e ployers substituted a very expensive b efit for a less expensive wage.

Only a few have disclosed what t may owe over the next 30 years, but so of the numbers that have come out staggering. New York State, including cities and counties, might have a liabi of $250 billion. The Los Angeles Uni School District could owe $10 billion, City of Nashville $1.5 billion, and the st of Maryland $20.4 billion. Those are e mates, of course, filled with assumptio including guesses at what health-c inflation will look like 30 years out.

Even so, Cecilia Januszkiewicz, s



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retary of Maryland's Budget & Management Dept., said that state's number was "shocking" to her. The previous estimate from several years earlier had been $3 billion to $6 billion. Actuaries have told Maryland that if the state were to begin funding retiree health care the way it does pensions, i.e., by creating a special fund aimed at ensuring it will have enough cash to pay benefits in the future, annual spending on retiree health care would jump to $1.9 billion a year, from $311 million today.

Nationwide, the 30-year tab could total $600 billion to $1.3 trillion, according to JPMorgan benefits specialist Brian Whitworth. "They're finding just how big the promises are they've made," says J. Richard Johnson, head of Segal Co.'s public-sector health practice. "And how do you describe enormous?"

Dealing with the issue won't be easy. Cutting the benefits of lifelong teachers, firefighters, and policemen is not only distasteful, for politicians it's dangerous. These groups all vote, and elected officials controlling state purses know it. Many states also make it illegal to cut government retiree benefits once they've been promised. And some retirees, worried that governments will opt to cut benefits rather than come up with the billions needed to cover future costs, are opposed to a knee-jerk response. "I don't think you can get an accurate number on it," says Robert W. Pickett, who retired in 1998, having served as chief financial officer for Alabama's Transportation Dept. for 26 years. "You've got to guess how long the retired will live, how long active employees will work, how long they will live after they retire. There are so many unknown variables."

CREDIT-RATING CONCERNS

SOME EMPLOYERS are biting the bullet and beginning to save. This year New York City, flush with taxes from Wall Street bonuses and a roaring real estate market, put $1 billion toward its $50 billion estimated liability and promised another $1 billion next year. The Peralta Community College District in Northern California issued bonds against the $153 million it will have to pay out, choosing a $4 million annual debt payment (starting in 2009) over health-care inflation they argue was starting to cut into their ability to ser the students.

In fact, the new accounting rul don't require states to fund the pr jected liability, just disclose it. But th bond market may. The major ratin agencies have urged governments n to panic, saying they consider mar factors when judging default risk. B the projected shortfalls are starting become a problem for some. In a No 9 report on Contra Costa County California, Standard & Poor's analys

Billions in Rx

Most public employers have only begun to calculate the long-term cost of their retiree health care, but for those who have, the numbers are big

	CURRENT ANNUAL OUTLAY	UNFUNDED 30-YEAR LIABILITY	COST PER CITIZEN OVE 30 YEARS
NEW YORK CITY	$911 MILLION	$48.0 BILLION*	$5,936
WEST VIRGINIA	100 MILLION	8.0 BILLION	4,403
ALABAMA	80 MILLION	20.0 BILLION	4,388
MARYLAND**	311 MILLION	20.4 BILLION	3,643
DELAWARE	100 MILLION	3.0 BILLION	3,555

*Total after $2 billion infusion
**State retirees only, does not include teachers
Data: Government reports, *BusinessWeek*

explained their negative outlook on th county as partly due to pressures fro its $2.57 billion retiree health-care ol ligation. And in Alabama, finance chi Jim Main has been pushing for the sta to create a trust for retiree health ca to help his bid for a better bond ratin for an upcoming $500 million offerin Alabama's liability for teachers and sta employees, at $20 billion, is hefty con pared with its annual revenue.

Not all states and cities are facin a funding crisis. Either they offer fe benefits and therefore owe very litt or nothing at all or, like Ohio, Cal fornia's Santa Clara County, and L Angeles, they started funding the promises years ago and are close halfway covered.

Cities and counties with large grou of firefighters and police who retire rel tively early may be among the worst o It's an issue that "is not going to get r solved quickly here or in any other city says David Manning, Nashville's direct of finance. Or painlessly, either. ■

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China MBAs: Most Likely to Fall Short

Corporate recruiters say graduates of mainland programs lack workplace savvy

BY DEXTER ROBERTS

NO DOUBT ABOUT IT, the Masters of Business Administration degree is a hot commodity in China. Fifteen years ago, then-paramount leader Deng Xiaoping oversaw the creation of China's first nine MBA programs. Today 230 programs graduate some 20,000 students a year.

Unfortunately, quantity and quality do not go hand in hand. Despite the explosion in Chinese B-schools, most corporate recruiters give graduates middling to poor marks, according to a *BusinessWeek* survey of 173 corporate recruiters at both Chinese and multinational companies with operations on the mainland.

In our survey, undertaken by recruitment consulting firm Universum Communications Inc., fewer than 20% of respondents described Chinese MBA graduates as either good or excellent, and only 34% said students' quality had improved over the past three years. "Students lack confidence and have no ic how to express themselves," said Nc Kang, of AIG Business Consulting, i typical comment. "Short on the spirit risk-taking," said Teresa Li, group dir tor of human resources and administ tion at Tristate Holdings Ltd., a Ho Kong garment manufacturer.

HUGE TUITIONS

WHY ARE POTENTIAL employers d satisfied? One issue is that the lure big bucks from MBA tuitions, which

SHANGHAI JIAO TONG The school rises above a sea of inferior programs

na can run as n as $27,500 a 20-month rse of study, led to a flood ess reputable grams. "Many entrepreneurs and panies have set up their own univer- s, and the quality has gone down," Wang Fanghua, dean of the Antai ege of Economics & Management hanghai Jiao Tong University, a top- d school in our survey.

That means many companies are thinking twice about hiring newly minted MBA grads. Some employers also note that an educational system emphasizing rote memorization and deference to authority doesn't turn out take-charge managers. "In the classroom, we can get students to analyze the heck out of a problem, but to get them to make a decision is very difficult," says Lydia J. Price, associate dean at the MBA program at China Europe International Business School, a joint venture between the Shanghai government and the European Union. CEIBS won top ranking in overall quality in our survey.

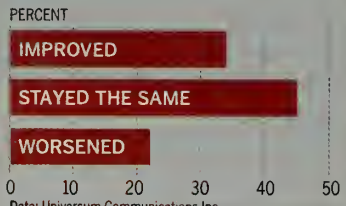
No wonder many employers prefer Chinese grads from B-schools outside China such as Harvard, Stanford, and Wharton. "The strength of instruction that they get in these programs, plus the experience they get studying overseas, makes [these] graduates very attractive," says Emre Demokan, senior manager of staffing for Microsoft China.

To ensure that Chinese B-school grads have the skills they desire, some companies are taking a bigger role on campus. At Beijing University's Guanghua School of Management, any company that hires more than five students is invited to join in interviews from which the next year's incoming class is chosen. Guanghua has developed particularly strong relations with Lenovo, Samsung, IBM, Lucent, China Mobile, and Bank of China.

Companies like Philips Electronics, one of the largest foreign investors, also find Chinese MBAs need more training. "We are not just bringing them in," says Elizabeth Martin-Chua, executive director and senior vice-president, Greater China, for Philips Electronics China Group. "There must be a coach and a mentor to support their growth." ■

LEARNING CURVE

Survey: How has the quality of China MBA grads changed over the past three years?



Data: Universum Communications Inc.

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ith your doctor first. Make sure you are healthy enough e sex. If you have chest pain, nausea, or other discomforts sex, seek medical help right away.

gh erections lasting for more than four hours may occur with all ED treatments in this drug class, to avoid long-term s, it is important to seek immediate medical help.

instances, men taking PDE5 inhibitors (oral erectile ction medicines, including VIAGRA) reported a sudden se or loss of vision. It is not possible to determine er these events are related directly to these medicines ther factors. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

Please see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

VIAGRA is covered on the majority of National Health Plans.[1]* VIAGRA is one of several ED treatments that you and your doctor can consider.

*HMOs and PPOs; Some plans may require a prior authorization.
[1]MediMedia Information Technologies, Formulary Compass™ August 2006.

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PATIENT SUMMARY OF INFORMATION ABOUT VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- Nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- Isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- Have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- Have ever had a stroke
- Have low or high blood pressure
- Have ever had severe vision loss
- Have a rare inherited eye disease called retinitis pigmentosa
- Have ever had any kidney problems
- Have ever had any liver problems
- Have ever had any blood problems, including sickle cell anemia or leukemia
- Are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- Have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- Have stomach ulcers or any types of bleeding problems
- Are taking any other medicines

• VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking medicines called alpha-blockers for the treatment of high blood pressure or prostate problems, your blood pressure could suddenly drop. You could get dizzy or faint.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

Your doctor may prescribe a lower dose of VIAGRA in certain circumstances. For example:

- If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA.
- If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.
- If you have prostate problems or high blood pressure for which you take medicines called alpha-blockers, your doctor may start you on a lower dose of VIAGRA.

• How To Take VIAGRA

Take VIAGRA about 1 hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose

In case of accidental overdose, call your doctor right away.

• Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

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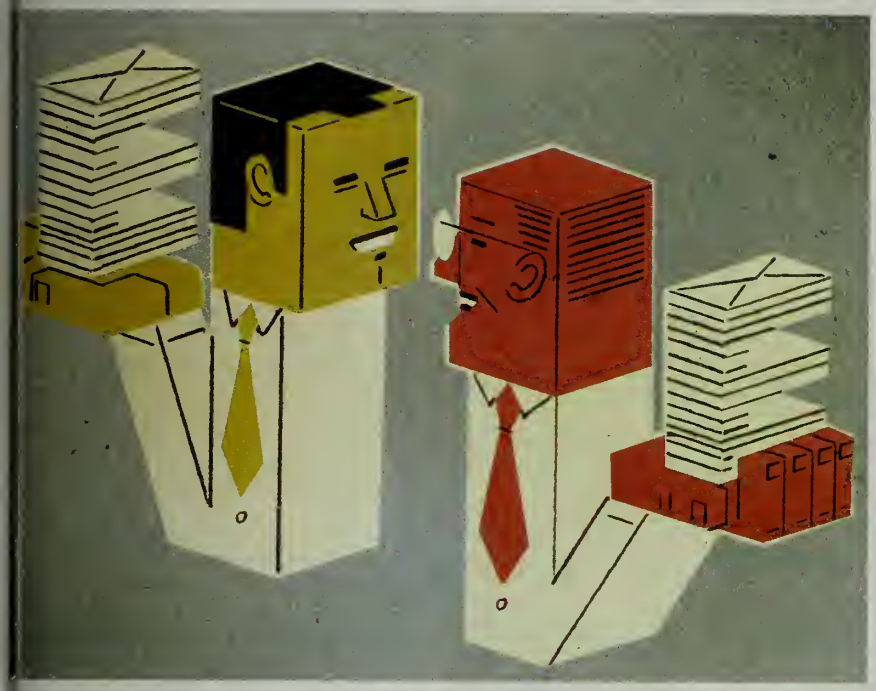

!#?@ the E-Mail. Can We Talk?

ace-to-face meetings can trump technology. ome companies call for "no e-mail Fridays"

DIANE BRADY

SCOTT A. DOCKTER KNEW things were bad when he found himself e-mailing his assistant seated a few feet away. But it was more than his own e-mail habit that prompted the CEO of PBD Worldwide Fulfillment Services in Alpharetta, Ga., to launch "no e-mail Fridays." He suspected that overdependence on e-mail at PBD, which offers services like call center management and distribution, was hurting productivity and perhaps sales. So in July, he instructed his 275 employees to pick up the phone or meet in person each Friday, and reduce e-mail use the rest of the time.

That was tough to digest, especially for younger staffers and some senior managers. "We discovered a lot of introverts...who had drifted into a pattern of communicating by e-mail," Dockter says. But in less than four months, the simple directive has resulted in quicker problem-solving, better teamwork, and, best of all, happier customers. "Our relationship with PBD is much stronger," says Cynthia Fitzpatrick of Crown Financial Ministries. "You can't get to know someone through e-mail."

While the BlackBerry has become standard armor for executives, a few maverick leaders are taking action to reduce e-mail use. The problem isn't the distraction of spam or stuffed inboxes. Nor is it the potential for legal liability. The concern, say academics and management thinkers, is misinterpreted messages, as well as the degree to which e-mail has become a substitute for the nuanced conversations that are critical in the workplace. "Business has undervalued the social dimension of communication," says Daniel Goleman, whose new book, *Social Intelligence*, examines the science behind interpersonal connections.

Recent research suggests that the perils of e-mail are greater than many assume. Justin Kruger, a professor at New York University's Stern School of Business, has found that as few as 50% of users grasp the tone or intent of an e-mail and that most people vastly overestimate their ability to relay and comprehend messages accurately. Smiley faces and exclamation points just add another layer of confusion. Misinterpretation is highest, Syracuse University professor Kristin Byron has discovered, when the e-mail comes from a boss.

STUBBORN HABIT

STILL, FEW COMPANIES have tried to tackle the problem of e-mail run amok. As International Association of Business Communicators President Julie Freeman notes, most corporate policies are "aimed at protecting the e-mail system rather than helping you be an effective communicator." Many companies are adding collaborative tools such as communal Web pages (wikis). But the challenge of getting people to talk remains, especially among younger staffers for whom e-mail or text-messaging has become the default mode of discussion.

Such issues call for an overhaul of e-mail policies. Richard A. Chaifetz, CEO of Chicago-based employee assistance provider ComPsych Corp., has directed his 350 staffers to curb e-mail. "It should be used to send a large document to read, or when written communication is absolutely necessary," says Chaifetz. Others urge banning it in sensitive situations such as major announcements, firings, job evaluations, and any form of criticism.

Another solution may come from the home of the Outlook e-mail system itself. In its 2007 version of Outlook, which goes on sale to corporate customers on Nov. 30, Microsoft Corp. has created a tool that elevates the humble telephone. Users can click on colleagues' names, see if they're available, and use the program to place a call directly.

While Dockter's solution was decidedly less high-tech, it has already changed PBD's culture. E-mail usage has dropped more than 80%, prompting improved communication and more one-on-one interaction between colleagues. Clients are so impressed that they have started to visit and call his staffers more often, too. The biggest peril now? Getting trapped in telephone tag. ■

VREELAND He has Porthault opening tony new stores and expanding its line

Snuggling into The Voile Sheets

Private-equity firms are gambling on France's cottage industry of prestigious brands

BY ERIC SCHINE

SO LONG OIL PATCH, hello Paris. That sums up the strategy of Brazos Europe Inc., a little-known private-equity group made up of former associates of billionaire Robert M. Bass, the famous Texan investor. They've made their fortunes in everything from distressed real estate in Canada to oil and gas deals in Chile. Now the Washington (D.C.)-based Brazos expects to strike gold again, this time in the European luxury market.

For starters, the two principals, Bernard J. Carl and Shannon Fairbanks, are investing about $25 million to acquire and develop D. Porthault, the family-owned maker of ultra-upscale linens and one of France's most prestigious luxury brands. They're following up with a $300 million fund to invest in French family businesses, with an emphasis on luxury deals. Fluffy French pillowcases and intricate floral embroidery don't sound like they're in th same league a oil and gas, y Brazos sees ple ty of dollar sig amid all the frills. Says Brazos Preside Carl: "Porthault is one of the most ma sively underexploited brands out there."

It's easy to see the appeal of Europea luxury brands these days. French gian like LVMH Moët Hennessy Louis Vuitto with such brands as Louis Vuitton ar Fendi, and PPR, which owns Gucci ar Yves Saint Laurent, are logging reco profits as the carriage trade expands acro the globe. Yet operating under the radar these titans is a constellation of small, far ily-owed French luxury businesses that a holding on for dear life. The French go ernment estimates there are about 3,0 treasured artisanal firms designated *Entr prises du Patrimoine Vivant*, or compani of France's living heritage, about a third which serve the luxury market. These bus nesses, says Renaud Dutreil, the Minist of Small & Medium Businesses, are part "the genetic code of France."

CREAKY FACTORY

MANY ARE ALSO low-hanging fruit f the likes of Brazos. Small luxury cor panies, often in the same family f centuries, are in need of fresh ideas, ne talent, capital, and modern distributio And the money is starting to come in. La year Asim Abdullah, a Pakistani-America dot-com billionaire, purchased the onc hot French couturier Emanuel Unga from an Italian luxury company. Christ fle, the renowned maker of luxury tabl ware, recently sold a roughly 20% stake Japanese investment company BSL Co And Lanvin, the haute couture fashi house, is now owned by a Chinese grou

Of course, plenty of outsiders have lo money trying to play in the closed wor of French luxury. But Brazos figur the time is right to move in, and it se Porthault as the perfect place to sta Porthault's factory in the north of Fran dates to the 1940s, its creaky machine is even older. Spotty production mea it had to turn down offers to supp Harrod's and other upscale chains.

Yet Porthault products have long he a powerful appeal for an upscale nic under its longtime chief, Marc Porthau the founders' son who once collaborat on a history of linens called *Rêves Blanc*. Porthault linens and bath tow have graced the Kennedy White Hou and the country homes of Britain's ro family. Celebrities, too, love to shell o up to $4,600 for a set of Porthault's si

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nature color-splashed, silky sheets, sor
decorated with tiny jewels. At an Octob
opening of Porthault's new boutique
tony Avenue de Montaigne, among tho
running their fingers through the comp
ny's selections were actresses Catheri
Deneuve and Gwyneth Paltrow.

'MADE IN FRANCE' PREMIUM

BRAZOS' STRATEGY IS to increase t
company's annual sales from just $7 m
lion to about $75 million within sev
years. The plan is to open a dozen
more elegant stores from San Francis
to Moscow to Tokyo and to expand in
the U.S. luxury hotel industry. Unde
new American CEO, Alexander Vreelar
a former marketing executive for Giorg
Armani, Porthault is creating its fi
catalog and Web site and expanding
offerings to include upscale nightgow
and tableware. Because luxury bran
tend to sell for one to two times sal
Carl is confident Brazos can realize
least a 30% annual rate of return over t
life of its investment.

Key to that strategy is keeping pric
for Porthault's products high by mai
taining quality and manufacturing o
in France. Says Carl: "You have no id
how much people are willing to pay
the 'Made In France' label."

But Brazos will need to steadily
crease Porthault's output to supply
growing distribution. The company h
built a $6 million, state-of-the-art text
factory, partly paid for by the Fren
government. Computer files will repla
the crumbling, hand-written cardboa
instructions on which the compan
2,000 or so patterns had been stor
Once sheets are produced in the new f
tory, they will move to the finishing cr
about 100 or so highly skilled sea
stresses trained from one generation
the next in the elaborate embroidery t
Porthault fans crave.

Will this bet pay off? The Americ
team has a rough road ahead. Just t
ing to figure out the company's marg
is a brain-twister. Because of decades
antiquated internal record-keeping,
don't have any level of confidence in
numbers right now," says Vreeland. I
there's no turning back. In the small to
of Rieux in the northeast corner of Fran
workers are putting the finishing touc
on the new factory set to open in Janu
French government officials will atte
And Vreeland and Marc Porthault
embrace for the cameras. For Rieux,
opening could mean prosperity for ye
to come. Brazos is hoping for the same.

–With Carol Matlack in P

ity and synchronization may require separately purchased equipment and/or wireless products (e.g., WiFi card, network software, server hardware, and/or redirector software). Service plans are required for WiFi and phone access. Features and performance may vary by service provider and are subject to network limitations. See device manufacturer, service provider and/or corporate IT department for details.

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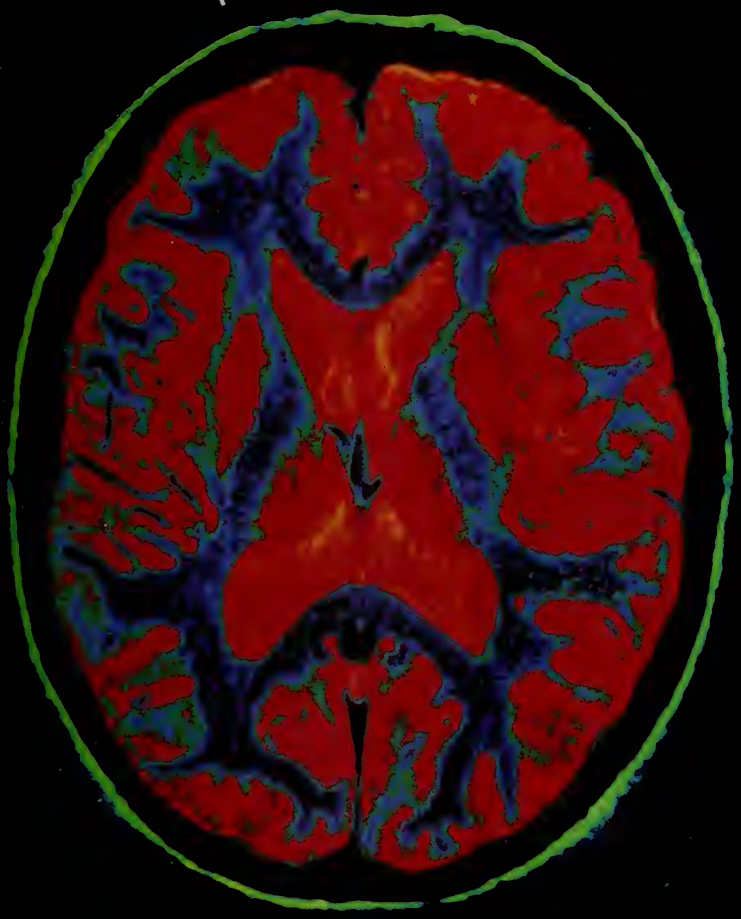

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BusinessWeek

The Gift Of Time

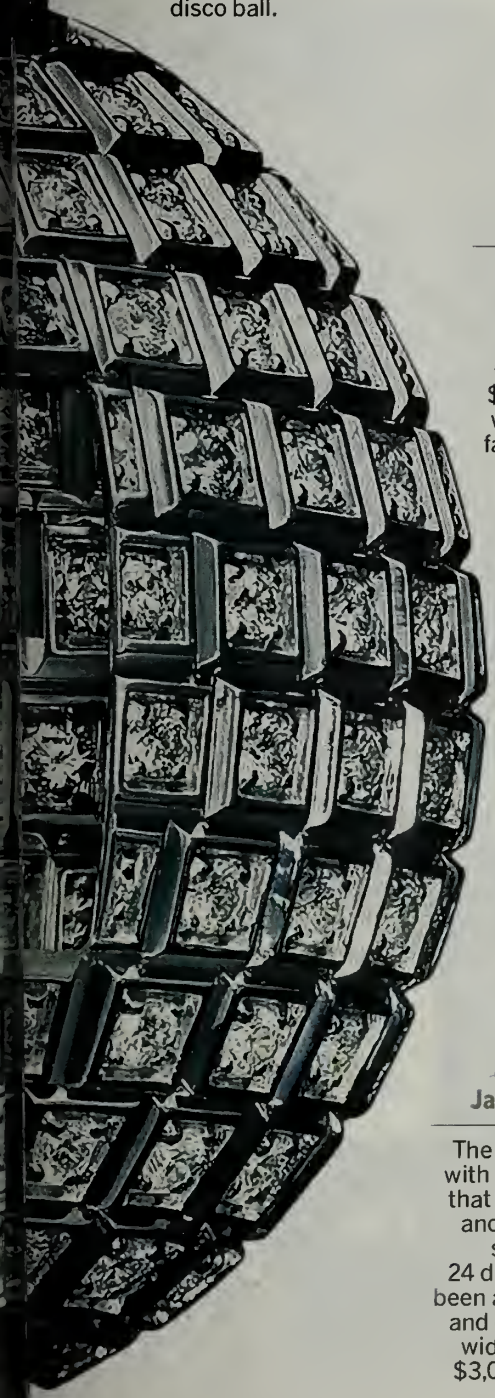
The season's hot watches sport retro looks, techno features, and dazzling gems

BY KATE MURPHY

AS GIFTS, WATCHES often symbolize a commitment to future time together. And this year, bigger may be better as watch-face sizes are expanding for men and women. Cartier doesn't even differentiate by gender any more, labeling its watches mini, small, medium, large, and extra large instead. Skeletonized timepieces that reveal their inner workings remain popular. An example is the limited edition Audemars Piguet Cabinet No. 5 ($320,300)—on the wish list of Matthew Morse, editor of *Revolution*, a magazine that chronicles what's hip in horology. Also in vogue are watches that tell time in multiple zones, retro styles, and for everyday wear, durable new ceramic watches like Chanel's chic J12 in basic black or white ($3,350-$3,650).

Limelight Party
Piaget

If bling is the thing, check out Piaget's Limelight Party watch for a mere $31,000. A sparkling orb of 123 brilliant-cut diamonds, it looks like a miniature disco ball.



T-Touch
Tissot

Techno-trendy watches like the Tissot T-Touch ($625) not only tell the time but also altitude, temperature, barometric pressure, and compass orientation if you press various points on its screen.

Calatrava
Patek Philippe

It's hard to go wrong with a classic design such as Patek Philippe's signature Calatrava (starting at $13,000). It's a simple white-face gold watch fastened by a crocodile leather band.

Reine de Naples
Breguet

This $223,000 eye-popping creation from Swiss watchmaker Breguet features a face of baguette diamonds and a bracelet with eight rows of white Tahitian pearls.

Reverso
Jaeger-LeCoultre

The art deco Reverso with its tank-style case that flips over to show another watch face, say, or time in 24 different cities, has been around for 75 years and continues to have wide appeal. It runs $3,000 to $100,000.

Big, Powerful, and Smooth

The Audi Q7 SUV drives like a sports car and is loaded with extras, which just might make it worth the hefty price. **BY MATT VELLA**

PRIZEFIGHTER The Q7's optional 4.2 liter V-8 produces 350 horses and plenty of road-gripping torque. That's more power than the Porsche Cayenne, BMW X5, Mercedes M-Class, and Range Rover Sport.

Q AS IN QUICK At 5,467-lbs. the Q7 is heavier than nearly all its competitors. Despite its heft, the V-8-equipped model goes from 0 to 62 mph in a silky-smooth 7.1 seconds. The electronically limited top speed, meanwhile, is 130 mph.

UNQUENCHABLE THIRST With the larger engine, it's rated to get between 14 and 19 miles per gallon. In my driving it averaged below that, at 13.4 miles per gallon.

EXHILARATING GEARBOX The real genius lies in the DSG automatic transmission, which can be shifted into a manual-like mode that activates wheel-mounted paddle shifters. Those enable blazing gear changes.

AIR MANEUVERS The adaptive air suspension, a $2,500 option, allows the Q7 to play well both on- and off-road. Audi's quattro, its standard all-wheel drive, certainly deserves its sterling reputation. But when the Q7 is equipped with the additional system, the click of a few buttons lifts the ride height to tackle tricky off-road obstacles or lowers it to noticeably improve on-road handling.

TECHNO TROLLEY A camera built into the trunk beams images to the dash to assist with parking. Better yet, the system overlays a 3D image of where the car is headed as the wheels turn. Another hand option is an intuitive mirror-mounted safe system that warns drivers when other car enter blind spots.

PRICEY PROPOSITION The top of the line Q7 has a base price of $59,900—more th its competitors. But that price includes a l of extras, such as a gorgeous three-panel panoramic sunroof that stretches from th front to the rear of the cabin, giving it an airy, open feeling. A version with fewer extras as well as a less powerful (and less thirsty) engine starts at more reasonable $39,9

KILLER LOOKS Audi's ne snout design is controversial in auto circles. The way the grill pulls the front of the car down toward the road works to give the hulking SUV a sporty look.

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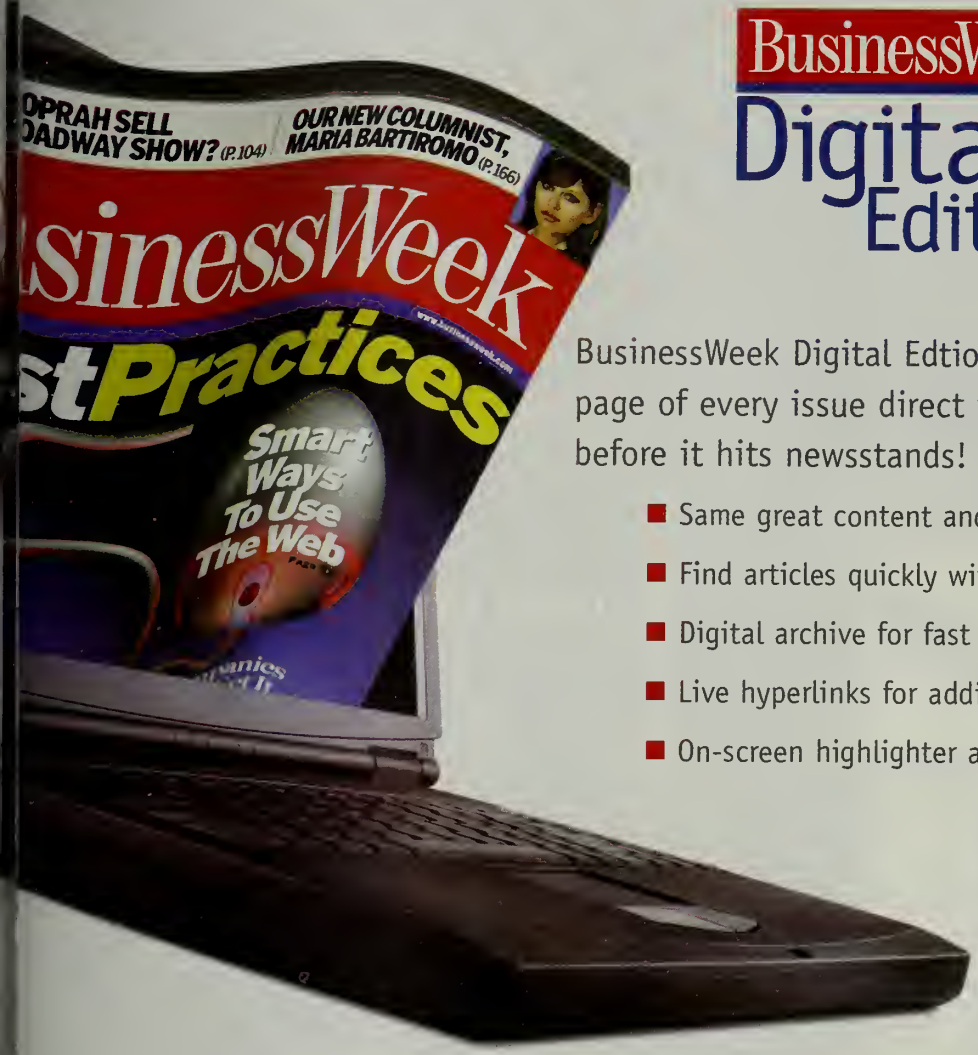

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low to put your foot in your mouth

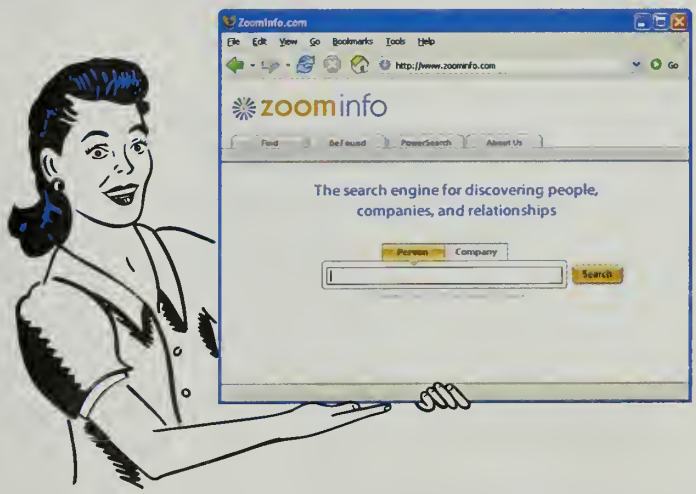
o not attempt while standing; instability and possible collapse may result!

Fig. 1. Remove shoe

Fig. 2. Open mouth

Fig. 3. Insert foot (do not bite)

low to keep your foot out of your mouth



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Clever Carry-Ons

Hitting the road for business can be exhausting, but innovative luggage can ease the burden. **BY NICHOLA SAMINATHER**

VERA BRADLEY ROLLING DUFFEL This 22-in. bag is the first two-wheeled duffel from the popular designer. It has a retractable handle and comes in prints as well as basic black ($180, verabradley.com).

BOOM BAG ROLLING OFFICE You're sure to be heard with this 18-in. bag's built-in speakers, which can project sound across a room that holds 300 people ($330, boombags.com).

TER CASE II The in. suitcase turns a luggage cart up to 200 lb. of er bags stacked op ($329, tercase.com).

SKYROLL ON WHEELS This carry-on comes with a 22-in.-by-48-in. garment bag that wraps tightly around its body. Held secure by adjustable straps, the bag has zippered pockets on the outside and mesh pockets on the suitcase side ($99, skyroll.com).

BY JONATHAN SCHWARTZ

The Making of A Jazz Classic

A BEAUTIFUL WOMAN in her forties. A Milwaukee girl, white as mil with long blonde hair. Never heard a lick of jazz until she was 19 and in college in Boston. Her singing, she discovered, was jazz-inflected. Her light soprano moved surely at any speed, landing squarely in the middle of each note. ¶ She appeared on the jazz scene as would the light of a distant star. After a brief marriage to a man who didn like her music, she found her way west, to California, where she has

remained since 1993. She would sing at any opportunity, with any pickup band or pianist. Then she found her lifetime collaborators within the big band of legendary West Coast trumpet player Jack Sheldon. Here was the rhythm section to match her voice: pianist Christian Jacob, bassist Trey Henry, and drummer Ray Brinker. Together in small clubs they found their sound and crafted their music from the collaboration. Her first album, *Introducing Tierney Sutton,* came out on a small Dutch label in 1999, and included songs by Richard Rodgers and Lorenz Hart, Jerome Kern, and Frank Loesser. That same year, Telarc Records picked her up, and it has stayed with her since.

Five albums later, Sutton will be releasing her best work yet early in 2007. *On the Other Side* is easily a masterpiece, taking happy songs and making them introspective, melancholy, ironic, and adult. Why make happy songs sad? "The founding fathers...guaranteed us, among other things, 'the pursuit of happiness,'" Sutton writes in the CD's liner notes. "Mystics tell us it's the chase that causes our problems. We chase happiness but often find the heartache of happiness lost or missed...."

On the new album, Harold Arlen's *Get Happy* appears twice, neither one ebullient. The first is cautious and dark, with Sutton's singing offset by the ominous beat of the bass—two basses, actually, as Trey Henry is joined by the first-rate Kevin Axt. Similarly, the two bassists give a frightening and funky backbone to *Happy Days Are Here Again,* another song that Sutton offers in two versions. The second *Happy Days* is more melancholy and austere than the first.

You Are My Sunshine, played in a minor key, is simply a knockout. You hear the depth of many kinds of loneliness the few moments of the recording. A b of a surprise: An outsider appears for first time. Jack Sheldon and his trumpet materialize on *Glad to be Unhappy* (again, with the minor key arrangeme to elevate the Rodgers and Hart stand and Tierney's singing to a Sinatra leve

Here, too, is a perfect recording of *Haunted Heart,* one of the most beautiful and shattering of songs in th Great American Songboo There's a comforting aspect to *I Want to Be Hap* (again with Sheldon) an a version of the ubiquito *Smile* that offers mostly shadows.

TIERNEY SUTTON

There are works of art in this world of ours, on LPs and CDs, like Frank Sinatra's *In the Wee Sma Hours,* Miles Davis' *Sketc of Spain,* and the Beatles *White Album.* Tierney Sutton's *On the Other Si* joins that rarified group because it is eloquent, honest, and magnificent sung and played. ■

Jonathan Schwartz hosts Frank's Place, a channel on XM Satellite Radio, as well a weekend shows on WNYC-FI New York public radio statio

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NASDAQ

BY ROBERT PARKER

A Reason to Veer Off The Chianti Trail

I'VE LONG BEEN AN ADMIRER of the Falesco Winery in the Italian province of Umbria. There, winemakers/brothers Renzo and Riccardo Cotarella have helped put Umbria—just east of Tuscany—on the viticultural map. They make expensive wines, but some of their lower-cost cuvées offer unbelievable value. All of these are made to be consumed during their firs several years. Falesco wines have good availability in the U.S., but call the importer, Winebow, at 201 445-0620 if you need help finding them.

2005 Vitiano Sangiovese IGT
90 points. This outstanding effort makes a mockery of many of the over-priced sangioveses emerging from other areas of the world. A stunning value, it boasts a beautiful bouquet of sweet cherries, strawberries, bay leaf, spice, and blacker fruits. Full-bodied with superb length, good underlying acidity, and a beautiful texture, it spent six months in barrels before being bottled. $11

2005 Vitiano Bianco IGT
89 points. This crisp, elegant white, equal parts unwooded vermentino and verdicchio, offers loads of tropical fruit, good body, impressive purity (a hallmark of all the Cotarellas' wines), and impeccable balance, as well as length. It provides a heck of a glass of dry white for the price. $11

2005 Vitiano Rosso IGT
89 points. A terrific bargain in dry red wine, this blend of nearly equal parts sangiovese, merlot, and cabernet sauvignon was aged in barrels for a short time. It exhibits a deep ruby/purple color, a rich bouquet of black cherry jam, licorice, tobacco leaf, and spice box, surprising density, and medium body. $11

2005 Vitiano Rosé IGT
87 points. A blend of 30% merlot, 30% sangiovese, 30% cabernet sauvignon, and 10% aleatico (which the Cotarellas believe provides personality and perfume). The wine has a big, sweet nose of strawberries, plums, cranberries, and flowers. In short, it's a fruity, dry, medium-bodied rosé possessing abundant personality.

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boarc tens of thousands of tasting notes, or to order his recent book, *The World's Greate Wine Estates: A Modern Perspective.* You can also subscribe to Parker's newsletter *The Wine Advocate.* Request a sample copy at: *The Wine Advocate,* P.O. Box 311, Monkton, MD 21111.

2005 Merlot Pesano IGT
90 points. An extremely intense, amazing bargain of a wine. This 100% merlot (barre aged for five to six months) exhibits a deep ruby/purple hue. The fleshy, deep aromas and flavors are black cherry, cassis, smoke herb, and mocha. This medium-bodied, concentrated, unbelievably well-priced rec almost too good to be true. $16

2004 Ferentano IGT
90 points. Produced from the indigenous and little-known roscetto varietal, this wh wine begins slowly and aromatically. The it starts to build intensity in the mouth, revealing a tremendous, layered, honeyec character reminiscent of a southern Rhôr blend of roussanne, viognier, and marsan Given its full body and intensity, you coul even serve it as an accompaniment to hearty meat dishes. This noteworthy valu represents a remarkable achievement fo this estate. $22

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/ex

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Don't Wait Till April

The end of the '06 tax year is upon us, so it's time to put your house in order. Here's a list of five places to start. **BY AARON PRESSMAN**

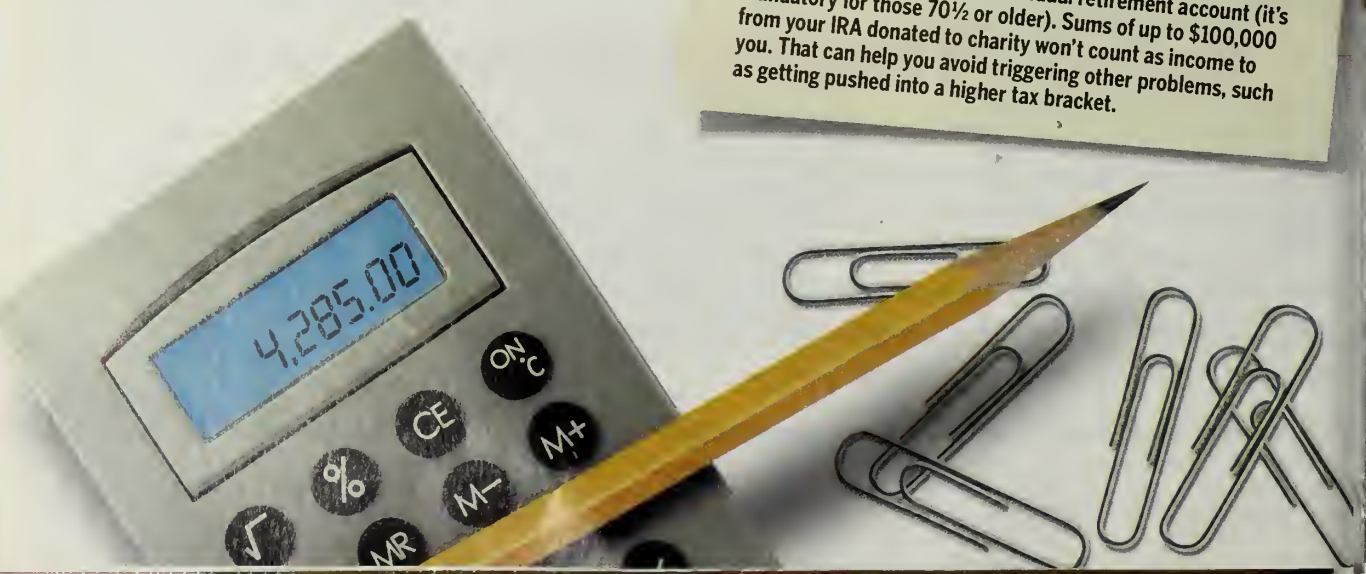
FROM AN INVESTMENT and taxpaying viewpoint, 2006 has been a pretty good year. The stock market is hitting new highs, important tax breaks for education savings were extended. Still, if you haven't done so already, you should take a hard look at your income and investments with an eye toward Apr. 15. Sure, that's months away, but you only have until Dec. 31 to make some smart moves that can produce big savings or avoid a bone-headed, expensive mistake. There weren't nearly as many tax law changes in 2006 as in the past few years, but here are five areas you need to check. In fact, the sooner, the better.

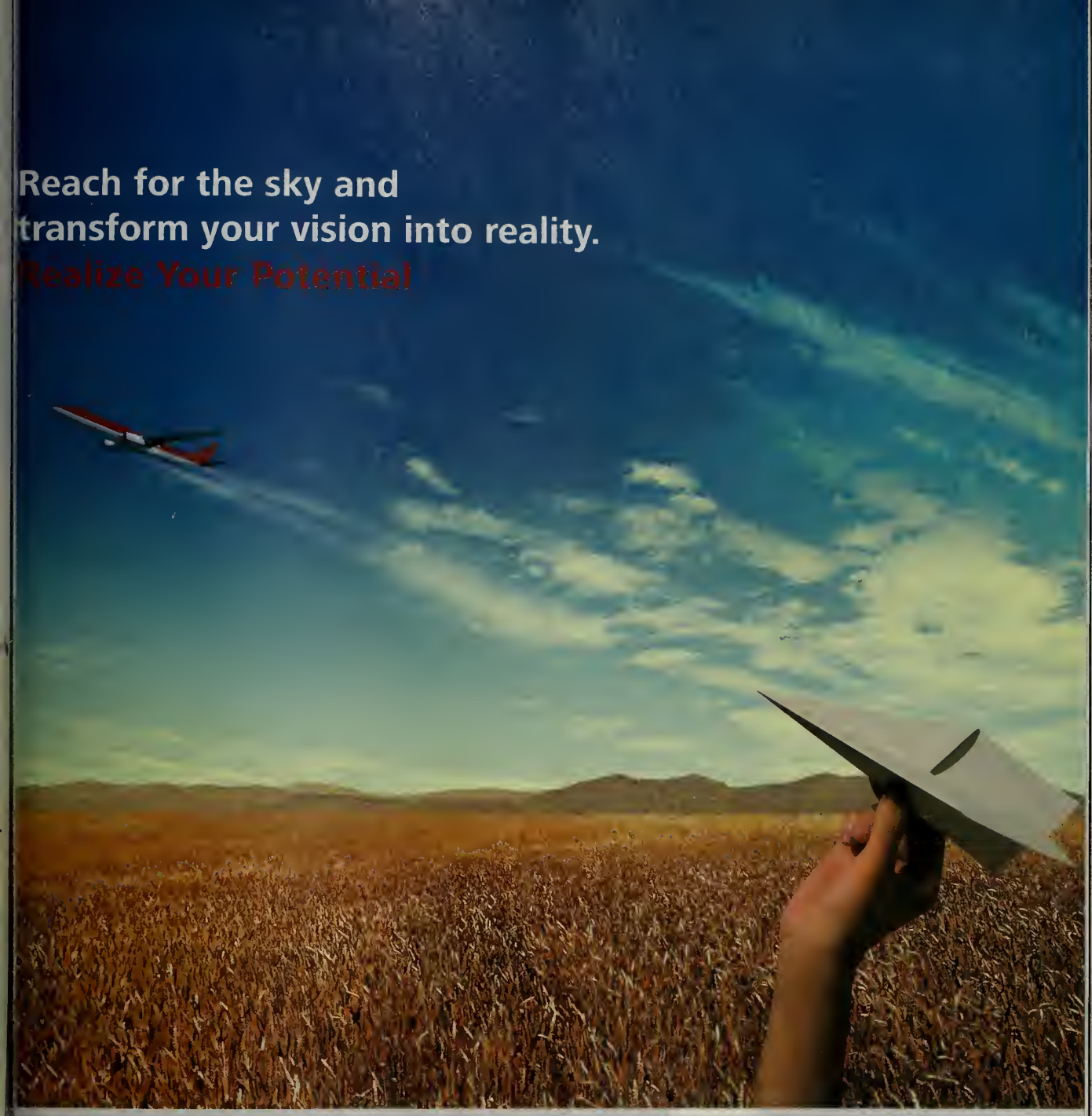
1 Charitable Donations

Before you write that check to your favorite charity, think about making the donation with appreciated stock. Giving shares directly to the institution allows you to take a charitable deduction for their full market value. If you sell stock and then make the donation from the proceeds, you'll have to pay tax on your gains.

Don't wait too long to tell your broker that you want to make such a donation, warns John Gay, a financial adviser at Frisco Financial Planning in Frisco, Tex. "A lot of people intend to do it, but it can take a week or two to complete the transaction," he says. Most religious institutions and well-known nonprofits can easily accommodate a stock donation, but some may have their own red tape. If the transfer isn't completed by Dec. 31, the deduction won't count for 2006.

This year and next also afford an opportunity if you are taking distributions from your individual retirement account (it's mandatory for those 70½ or older). Sums of up to $100,000 from your IRA donated to charity won't count as income to you. That can help you avoid triggering other problems, such as getting pushed into a higher tax bracket.





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2 Retirement Plans

You can make contributions to IRAs for 2006 up until Apr. 15, but there may be better plans for you—and those require you to act before yearend. For instance, if you're self-employed, a 401(k)-like tax-deferred account known as the Single K has the same pretax contribution limit as a 401(k)—for 2006, $15,000 a year withheld from salary (or $20,000 for people over 50). But it also adds a profit-sharing element that can exceed those amounts, allowing the self-employed to make contributions of up to 25% of the business' profits. The trick is that the salary portion must be contributed before Dec. 31. "It's a much better option for many sole proprietors," says Sacha Millstone, senior vice-president at the Millstone Evans Group of Raymond James & Associates.

If you've changed jobs this year you also need to do an immediate check on how much has been withheld in pretax retirement accounts. Because two employers may have withheld salary for a 401(k), it's possible you may have accidentally exceeded the annual limit. If you've made excess contributions, you need to get your employer to withdraw them by Apr. 15. Otherwise, you, in effect, end up with double taxation. The excess gets reported as income for 2006, and it will be taxed again when you start tapping the funds in retirement.

3 Expenses and Income

It's often a good idea near the end of the year to accelerate deductible expenses and defer income, but there are a few caveats. You may want to pay property tax bills in December that aren't due until January or February. That allows you to claim the deduction for property taxes in the current year. But watch out if your property taxes are held in escrow. Your mortgage company may not be as diligent about getting a check out on time as you would be. If the escrow holder pays even a few days late, you don't get the deduction until next year.

Unfortunately, this accelerated payment ploy doesn't work for interest on mortgages or loans, or for rent. The IRS won't consider it deductible for 2006.

It's also dicey to shift income into next year for work already done. Even arranging to have current salary deferred without risk and at your behest doesn't delay the tax liability, according to the IRS. Financial advisers warn that the IRS doesn't look kindly on delayed invoicing that appears out of the ordinary. Things get especially tricky for owners of small businesses that operate on an accrual basis. Under the accrual method, income is credited when services or sales occur, regardless of when the money is received.

4 Paying for Education

Congress finally got around to making permanent the federal deduction for contributions to 529 savings plans, making these tax-deferred education accounts a smarter choice for many parents. The tax change also prompted some plan providers like Fidelity and Vanguard to cut fees and offer additional investment choices, so it's worth revisiting the question of whether these plans are the most appropriate way to save for college.

If your youngster plans to start college next year, then you need to look again at your income and expenses for this year. That's because financial aid applications will focus on the full calendar year before a student matriculates. Even if there is no tax reason to defer income, keeping your income down could improve the prospects for a financial aid award. Online calculators such as FinAid (finaid.org/calculators) can show you the effect of different incomes on aid.

Going back to school for professional development in 2007? You may be able to take advantage of the lifetime learning credit, which pays a maximum of $2,000 per year. You can even collect the credit in two consecutive years for a hefty tuition bill in one year. Here's how: Prepay part of the tuition in 2006 for classes that start by Mar. 31, 2007, and you get the credit for 2006. Amounts paid in 2007 will apply to next year's taxes.

5 The AMT

Some tax moves may become irrelevant or even counterproductive if you wind up paying the alternative minimum tax. Created in the 1960s to prevent millionaires from avoiding taxes altogether, the AMT calculation disallows many popular deductions, such as state and local taxes. Your tax is whichever method produces the higher tax bill.

About 3.6 million taxpayers are expected to get hit by the AMT this year. Are you one of them? If you paid the AMT last year and your financial situation is similar this year, you're likely to get hit again. If you didn't, you may get hit if you live in a high-tax state and have several dependents. The IRS offers an "AMT Assistant" (apps.irs.gov/app/amt/index.jsp) to help you determine your exposure.

One of the biggest pitfalls with the AMT is that the tax applies to gains on incentive stock options that have been exercised even if the acquired stock hasn't been sold. If this applies to you, remember to take it into account when figuring your AMT.

Politicians in both parties have said they want to fix the AMT before it snags some 18 million taxpayers in 2008. What the pols haven't figured out is how to replace the cash it raises.

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A Dearth Of Deals

Why closed-end investors aren't doing much selling—yet

YEAREND TAX selling usually creates bargains in closed-end funds, those oddball vehicles that are managed like mutual funds but trade like stocks. So far this year the selling—and bargains—have been scant. Personal Business Editor Lauren Young checked in with Thomas Herzfeld, editor of *The Investors Guide to Closed-End Funds* newsletter, to find out why.

Why hasn't there been more selling of closed-end funds?
The stock market has been doing well. People are holding off taking their tax losses, but I do expect significant year-end selling.

What will be sold—and is any of it worth buying?
Funds with the biggest price losses are always the best candidates for tax selling. One of the worst performers is Tortoise North American Energy. About half of the portfolio is invested in Canadian income trusts. On Oct. 31, the Canadian government announced plans to change the tax treatment of the trusts, and the fund's share price collapsed. The proposed tax changes won't happen for four years, and current outlook for the companies in the portfolio is very good.

Why do investors often dump new funds at the end of the year?
Those who buy new issues are often the uninitiated and uninformed. Their broker told them to buy it. But when a new fund trades below the offering price, they want to sell to take a tax loss. We've only had 17 new issues in 2006, and more than half of them have losses since their inceptions. In 2005 we had 47 new issues.

Why do municipal closed-end funds get hit at the end of the year?
Municipal funds always have some tax selling, and investors tend to dump the ones with dividend cuts, which create short-term trading opportunities. The one we are buying most is Alliance California Municipal Income Fund, a California municipal bond fund. It cut its dividend on Oct. 24, and its share price has dropped 9%.

What's ahead for closed-end funds in 2007?
New Securities & Exchange Commission rules make it easier to launch a closed-end fund of funds. The first of them slated to come to market will be the Cohen & Steers Closed-End Opportunity Fund, which will be looking to buy large-company funds that deliver high income. If these funds of funds are successful, there will be more demand for closed-end funds. That could result in fewer yearend bargains. ■

Taking Stock of Taxes

Fund investors, bewar of capital gains

BY LAUREN YOUNG

FIRST, THE GOOD NEV Thanks to a robust marl mutual funds are expec to make an estimated $2 billion in capital-gains c tributions by yearend. The bad ne That means investors could get a $ billion 2006 tax bill.

If you intend to purchase or se mutual fund before Dec. 31, find if it plans to make payouts and if when. Don't buy until after a distri tion, "otherwise you'll be paying the gains you weren't there to enjo says Morningstar analyst Christop Davis. If you're thinking of sellin fund in which you have long-te gains, you might want to get before payday if the fund is going be making short-term capital ga which are taxed at rates as high 35%. Long-term gains, whether t gered by your sale or by the fur payout, are taxed at a 15% maximu

Funds that are likely to post biggest distributions are typically best performers. At the top of the are small-company value funds, wh enjoyed gains even during much the bear market of 2000 to 2002 addition, natural-resource funds expected to make big payouts—ab one-quarter of the distributions expected to be short-term ga (Most large-com ny funds, meanwh still carry losses.)

How do you kn if a taxable ever heading your w Most funds put tribution infor tion on their w sites. Or call fund company's free number. ■

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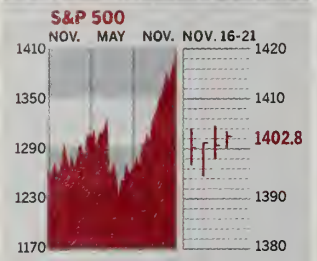


COMMENTARY

No volatility, no problem. While investors worried that stocks would fall as the S&P Volatility Index hit its lowest level since 1994, the S&P 500 kept rising. Google topped $500 per share, while signs of strong demand pushed Boeing and John Deere to record highs. REIT's surged on news that private-equity firm Blackstone Group is buying Equity Office Properties Trust.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	NOV. 21	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1402.8	0.4	12.4	11.8
Dow Jones Industrials	12,321.6	0.6	15.0	13.9
NASDAQ Composite	2454.8	0.5	11.3	9.5
S&P MidCap 400	808.6	0.3	9.6	10.0
S&P SmallCap 600	402.4	0.0	14.7	13.5
DJ Wilshire 5000	14,085.0	0.5	12.7	12.3

SECTORS

BusinessWeek 50*	794.4	0.3	7.1	4.9
BW Info Tech 100**	442.6	0.7	16.3	16.6
S&P/Citigroup Growth	651.8	0.5	9.3	8.4
S&P/Citigroup Value	748.8	0.4	15.6	15.4
S&P Energy	445.2	-0.6	19.5	18.0
S&P Financials	484.5	0.6	13.6	13.3
S&P REIT	201.2	5.4	31.5	30.6
S&P Transportation	276.2	1.1	10.6	11.6
S&P Utilities	181.9	0.3	13.9	15.1
GSTI Internet	201.9	0.9	-1.6	-3.9
PSE Technology	890.5	1.0	6.5	5.8

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	NOV. 21	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST MONT
S&P Euro Plus (U.S. Dollar)	1908.9	-0.1	26.3	32.0
London (FT-SE 100)	6202.6	-0.4	10.4	12.8
Paris (CAC 40)	5459.4	-0.9	15.8	19.0
Frankfurt (DAX)	6460.4	0.5	19.5	24.9
Tokyo (NIKKEI 225)	15,734.1	-3.1	-2.3	7.2
Hong Kong (Hang Seng)	19,008.3	-0.4	27.8	27.7
Toronto (S&P/TSX Composite)	12,602.3	1.4	11.8	16.5
Mexico City (IPC)	24,585.7	1.1	38.1	46.6

FUNDAMENTALS

	NOV. 20	WEEK AGO	YEAR AG
S&P 500 Dividend Yield	1.76%	1.77%	1.81
S&P 500 P/E Ratio (Trailing 12 mos.)	17.6	17.5	18.4
S&P 500 P/E Ratio (Next 12 mos.)*	15.2	15.1	15.0
First Call Earnings Revision*	-1.51%	-1.86%	-2.08

*First Call C

TECHNICAL INDICATORS

	NOV. 20	WEEK AGO	YEAR AG
S&P 500 200-day average	1300.8	1298.2	Positi
Stocks above 200-day average	71.0%	71.0%	Negati
Options: Put/call ratio	0.71	0.72	Positi
Insiders: Vickers NYSE Sell/buy ratio	5.46	4.84	Negati

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Internet Retailers	30.6	Steel	94.5
Tires & Rubber	20.9	Divsfd. Metals & Mining	57.0
Consumer Electronics	20.6	Department Stores	40.2
Photographic Products	17.1	Agricultural Products	37.8
Office REIT's	14.0	Investmt. Bnkg. & Brkrge.	37.6

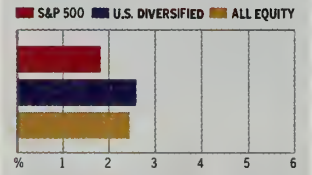
WORST-PERFORMING GROUPS

	LAST MONTH %		LAST MONTH
Agricultural Products	-10.1	Education Services	-50
Health-Care Services	-9.1	Homebuilding	-25
Managed Health Care	-7.3	Internet Software	-19
Drug Chains	-6.6	Health-Care Supplies	-15
Health-Care Supplies	-6.1	Managed Health Care	-14

MUTUAL FUNDS

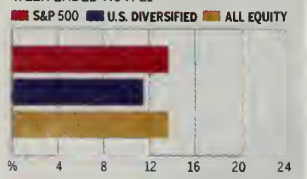
4-WEEK TOTAL RETURN

WEEK ENDED NOV. 21



52-WEEK TOTAL RETURN

WEEK ENDED NOV. 21



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Pacific/Asia ex-Japan	6.4	Latin America	36.8
Technology	4.9	Pacific/Asia ex-Japan	35.0
Precious Metals	4.8	Precious Metals	34.6
Diversified Emerging Mkts.	4.5	Real Estate	32.6
LAGGARDS		**LAGGARDS**	
Japan	-6.6	Japan	0.2
Diversified Pacific/Asia	-1.3	Health	4.8
Health	-0.1	Large-cap Growth	6.2
Foreign	1.6	Mid-cap Growth	8.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. Mble. Tlcmms. Inv.	15.2	Oberweis China Opport.	76.4
ProFds UltSh. Japan Inv.	14.2	Dreyfus Prem. Grtr. China A	68.2
Dreyfus Prem. Grtr. China A	12.6	ING Russia A	60.1
AIM China A	11.5	U.S. Glbl. Invs. Prc. Mnls.	60.0
LAGGARDS		**LAGGARDS**	
ProFunds. Ult. Japan Inv.	-12.6	Ameritor Investment	-88.9
DireXn. Japan Bull 2X Inv.	-12.6	DireXn. Emrg. Mkts. Short	-48.1
American Heritage	-12.5	DireXn. Sm. Cap Bear 2.5X	-31.0
DireXn. NASDAQ 100 Bear 2.5X	-10.4	ProFds. UltSh. Sm. Cap Inv.	-25.9

INTEREST RATES

KEY RATES

	NOV. 21	WEEK AGO	YEAR A
Money Market Funds	4.85%	4.84%	3.56
90-Day Treasury Bills	5.06	5.09	3.98
2-Year Treasury Notes	4.76	4.81	4.37
10-Year Treasury Notes	4.57	4.62	4.46
30-Year Treasury Bonds	4.66	4.70	4.66
30-Year Fixed Mortgage†	6.03	6.03	6.32

† BanxQuote

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BON
General Obligations	3.72%	4.149
Taxable Equivalent	5.31	5.91
Insured Revenue Bonds	3.81	4.34
Taxable Equivalent	5.44	6.20

THE WEEK AHEAD

DURABLE GOODS ORDERS *Tuesday, Nov. 28, 8:30 a.m., EST* » Durable goods orders are forecast to have dropped by 4% in October, following an 8% surge in September. That's the consensus estimate among economists polled by Action Economics.

EXISTING HOME SALES *Tuesday, Nov. 28, 10 a.m. EST* » Existing home sales in October probably remained at an annual rate of 6.18 million.

GROSS DOMESTIC PRODUCT (REVISED) *Wednesday, Nov. 29, 8:30 a.m., EST* » A second look at third-quarter real gross domestic product will likely show annualized growth of 1.7%, up a tick from the original 1.6% rate.

NEW HOME SALES *Wednesday, Nov. 29, 8:30 a.m. EST* » New-home sales probably edged down to an annual rate of 1.05 million for October. Sales in September rose to a pace of 1.08 million.

PERSONAL INCOME *Thursday, Nov. 30, 8:30 a.m., EST* » Personal income is expected to have risen by 0.5% for a second straight month. Consumer spending probably held steady, after a 0.1% rise in September.

PURCHASING MANAGERS' INDEX *Friday, Dec. 1, 10 a.m., EST* » The Institute for Supply Management's November factory activity index likely improved to 52%, from 51.2% in the prior period.

The *BusinessWeek* production ind edged down to 283.6 for the week ended Nov. 11, an 8.3% gain from a year ago. Before calculation of the four-week moving average, the index rose to 283.2.

BusinessWeek.com

For the BW50, more investmen data, and the components of th production index visit www.businessweek.com/extras

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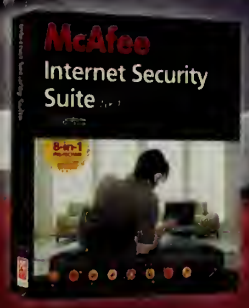

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BY GENE G. MARCIAL

PREDATORS MAY BE EYEING BOYD'S VALUABLE NEVADA LAND.

HUMVEES AND OTHER DEFENSE GEAR KEEP ARMOR ROLLING.

WHY SANGAMO BIOSCIENCES COULD BE A TEMPTING TARGET.

Boyd: A Buyout in Vegas?

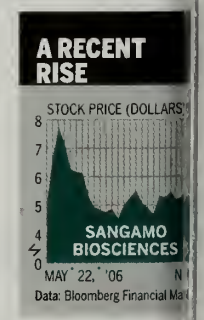
BOYD GAMING (BYD) may be the next target in the buyout wave sweeping Las Vegas. On Oct. 25, Harrah's Entertainment, featured in this column on May 29, got a $15 billion bid from Texas Pacific Group and Apollo Management. Earlier, casino owner Aztar was bought out after a four-way bidding war. "This time, it is Boyd, which owns and operates casinos in Nevada and four other states, that may be taken private," says Lawrence Haverty of Gabelli Global Multimedia Trust. He identified Harrah's, Aztar, and media giant Tribune months before they became targets. Like them, Boyd owns valuable assets that are way underpriced, says Haverty, who puts its "private-market value" at 70 a share. The stock is now at 42.11, and Chairman William Boyd owns a 30% stake. Boyd's big attraction is its real estate in Vegas, Haverty says. It also owns 50% of the Borgata Hotel Casino & Spa in Atlantic City with MGM Mirage. Major operators such as Steve Wynn or deal-hungry private equity groups could go after Boyd, says Haverty. But he says the most "fascinating player" who may make a bid is Carl Icahn, who already owns the Stratosphere and "is still trying to get a major foothold in Vegas." Icahn knows the value of land in Vegas, he adds. Lawrence Klatzkin of Jefferies, who rates Boyd a "buy," notes that it is down 35% since its peak in April, but its "long-term potential hasn't changed." One big project is the $4 billion Echelon Place casino at the north end of the Strip, scheduled to open in early 2010. Boyd declined comment on any speculation.

Armor's Defenses Are Looking Formidable

ALTHOUGH ARMOR HOLDINGS (AH) missed its third-quarter earnings forecasts, driving the stock down from 55 to 51 on Oct. 20, the Street remains upbeat on the big maker of armored military vehicles—mainly the Humvee—and aircraft armor and safety systems. The stock has since edged back to 55.05. Michael Metz, chief investment strategist at Oppenheimer, says there's talk that Armor may be acquired by the likes of Lockheed Martin. Some 74% of Armor's sales come from its aerospace and defense unit, which supplies systems to the U.S. military and aerospace and defense contractors. It is the sole supplier of blast-protection systems for the Humvee. Ivan Feinseth of Matrix USA, who has a "strong buy" on it, puts its "economic value" at 75. Worldwide demand for Armor vehicles and body shields continues to rise in military and private markets, he says, and Armor is the leader in both. Armor declined comment.

Ripe for Progress At Sangamo

BIOTECHS ARE GAINING TRACTION in the current buyout mania, with Big Pharma taking the lead. Merck has just acquired Sirna Therapeutics. Other buyers "are looking for biotechs with novel science behind their products," says Navdeep Jaikaria, a biotech analyst at Rodman & Renshaw. He thinks one that will entice Big Pharma is little-known Sangamo BioSciences (SGMO), wh has already partnered with some drug makers, including Pfizer, Dow Chemical and Edwards Lifesciences in developing its novel technology: It harnesses a natural cellular process aimed at regulating or modifying disease-related genes in humans and other organisms. The technology is broadly applicable for human therapeutics, agriculture, and protein manufacturing, says Pamela Bassett of Cantor Fitzgerald, who rates Sangamo, now trading at 6.81, a "buy," with a 12-month target of 17. Sangamo is developing potential products for diseases such as diabetic neuropathy, congestive heart failure, and HIV. She expects phase II clinical trials to star before yearend 2006 for Sangamo's lead product for diabe neuropathy, and phase I trials on its new HIV treatment i early 2007. ■



BusinessWeek.com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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IT'S BUSINESS TRANSFORMATION FOR TELCOS IN 2007:

PUTTING THE BACK OFFICE FRONT AND CENTER

Telecom providers have their hands full these days. New players are flooding the market, innovative services are being introduced weekly, and incumbents are slashing prices—all while profits are deflating. This perfect storm is sending telecom companies scurrying to their strategic playbooks, as they look to generate new revenues, become more agile and customer-oriented, and cut costs.

Experts agree that the most effective approach is to address the telecom "back office"—the operational support systems (OSSs) where services are created, managed, and delivered. But challenges exist there as well: The OSSs that manage modern telecom networks are plagued by heterogeneous information technology infrastructures, software that can't share data, and customization requirements that make it hard for companies to expand or migrate their systems.

"Transforming operations and cutting costs requires that providers adopt a 21st-century approach to correcting these problems," says Keith Willetts, chairman of the TeleManagement Forum, an organization dedicated to telecom back-office management issues. "Making this degree of change is not unlike turning around an oil tanker: It's a relatively slow process that requires long-term commitment."

Savvy players understand the goal. "The ability to create and deliver services that customers want is the silver bullet," says Sanjay Mewada, vice president of strategy for NetCracker Technology Corp., in Waltham, Mass. "The more efficient, error-free, and adaptable that capability, the more likely you can create a unique mix of services and deliver it when and where customers want."

The service delivery platform used by most telecom providers is too compartmentalized, rigid, stove-piped, and customized to quickly assemble and manage those services says Mewada. The ideal platform would be agile enough to create and deliver services on the fly, with little customization

"Providers need to look for software that is open, configurable, and standards-based," Mewada says. "Choosing solutions that are extremely interoperable and flexible is best." He advises customers to look for software that is

A Lurking Danger

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econfigured and also reusable—what he calls "service-ented architecture for the back office."

One approach is to select software that simplifies the oblem by segregating the back-office systems from the twork. "OSS integration is one of the biggest challenges introducing next-generation networks and services," says ris Purdy, CTO of Nakina Systems Inc., an Ottawa software ovider that partners with HP to serve the telecom market. uch as a computer operating system hides complexity from ftware applications, telecom providers need solutions that n abstract the complexity of heterogeneous networks in der to deliver compelling value-added services."

Nakina and HP have already deployed such OSSs in r-one carriers that "virtualize" the network and provide phisticated service-management capabilities. One tele-m company used it to save from $1 million to $2 million each type of network equipment deployed. In addition, provider estimated an annual savings of $14 million in erating expenses and found that new services introduc-n was accelerated by 60%.

"Helping service providers focus on what customers nt requires a new approach," says Michele Campriani, ector of OSS solutions for HP's communications, media, d entertainment unit. "Delivering the right quality and the nt services is difficult to do if you're focused on back-end hnology. Only a strategy that delivers universal mediation d uses best-in-class operational systems allows service oviders to become service-centric."

Fortunately, innovative technology options are arriving that will help streamline the telecom back office. Add best practices to the mix, and the path to business transformation for today's telecom providers is clear.

ABOUT THE TELEMANAGEMENT FORUM

For almost 20 years, the TeleManagement Forum (TM Forum) has provided leadership, strategic guidance, and practical solutions to improve the management and operation of information and communications services. The TM Forum creates collaboratively developed, industry-standard solutions, delivered via guidelines and specifications, that define a specific roadmap for achieving business efficiency and operational flexibility.

The TM Forum has more than 540 members in 63 countries, including service providers, equipment and software suppliers, and systems integrators. For further information, please visit www.tmforum.org.

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ransforming the Back Office Into a trategic Office the NetCracker Way

elecom used to be about shiny new work technology. But not any more. Serious petition is forcing traditional telecom ers to deliver more innovative services, e cost effectively, at a high level of quality. most innovative carriers are getting rid network-centric view of the business and acing it with a new service- and customer-ered alternative.

Back in the 1950s and '60s gasoline panies used to compete over the quality of gas," explains Andrew Feinberg, President CEO of NetCracker Technology, one of the panies supplying the new generation of IT ems required for the transformation. "But tually drivers figured out that gas is just and so the retailers switched their focus to d and service."

perators are spending 30 billion a year on the ack Office.

einberg suggests that telcos are undertaking imilar transition today. "Instead of entrating on the network and its technology, re becoming service-focused. They're g to maximize the user's experience of the service, not the technology's experience of running it." And NetCracker is leading this fundamental industry transformation.

NetCracker supplies 'Strategic Office' solutions—systems that create, provision, and fulfill services—to leading telcos around the globe. This is the third year in a row that NetCracker has more than doubled its worldwide personnel—an outstanding record in an industry that's currently used to single-digit growth.

The company believes that telcos must focus on the "service layer," the network of IT systems and software that create, deliver, and manage the services that run over the network and therefore define customer experience in terms of reliability, customer care, and the timely offering of new services.

"The term 'Back Office' is no longer accurate," says Feinberg. "We now talk about the 'Strategic Office' because a service provider's performance in the market will be defined by how they transform this part of their business."

Not surprisingly, service providers spend a significant chunk of their Operations Expenditure—as much as $30 billion a year—on the systems, software, and services associated with their Back Office.

Transforming the Back Office into the Strategic Office is crucial. Increasing competition and high costs associated with an inflexible Back Office are adding to the urgency.

Increased competition has incumbent providers reevaluating their operations like never before. Newer, leaner players have forced legacy-strewn incumbents to develop more Internet-friendly business models. In today's online world, customers prefer to sign up for services, pay their bills, and even personalize their services online. Hence, a strategic Back Office, where services can be provisioned and billed for on the fly is not a luxury—it's essential.

Today's communications marketplace has evolved. Players like Google and Amazon are introducing new economic and business models. And to successfully challenge these agile competitors, incumbent operators know they have to develop an IT infrastructure that will lower costs, rapidly deploy new services, and maintain the highest level of quality.

NetCracker Technology serves leading Tier 1 service providers all over the world.

NetCracker Technology Corporation

Established: 1993
Headquarters: Waltham, Massachusetts
Offices: London, Kiev, Melbourne, Moscow
Employees: over 1,000
www.netcracker.com

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Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A
ABC (DIS) **138**
ABI Research **68**
AIG (AIG) **106**
AirTran Airways (AAI) **84**
Alitalia **84**
Allergan (AGN) **30**
Amazon (AMZN) **20, 56**
American Express (AXP) **68, 96**
AMR (AMR) **84**
AOL (TWX) **42**
Apollo Management **132**
Apple (AAPL) **56, 68**
Armor Holdings (AH) **132**
Associated Press **26**
AT&T (T) **81**
Audemars **114**
Audi **13, 44, 116**
Aztar (AZR) **132**

B
Bain **30, 50**
Bank of America (BAC) **16, 30**
Bank of China **106**
Bear Stearns (BSC) **84**
Beiersdorf **16**
Blackstone **30, 36**
BMW **13, 116**
Boeing (BA) **84**
Boom Bags **119**
Boston Consulting **84**
Boswell Group **18**
Boyd Gaming (BYD) **132**
Brazos Europe **110**
Breguet **114**
Bridgewell **46**
Broadcom (BRCM) **68**
Brookfield Properties (BPO) **36**
BSL **110**

C
Campbell Soup (CPB) **96**
Cantor Fitzgerald **132**
Carlyle Group **81**
CarrAmerica (CRE) **36**
Cartier **114**
Chanel **114**
Charles Schwab (SCHW) **30**
Chicago Mercantile Exchange (CME) **46**
China Mobile (CHL) **106**
Christofle **110**
Cingular Wireless (T) **68**
Citigroup (C) **36, 46**
Clear Channel (CCU) **30**
Cohen & Steers **128**
Comcast (CMCSA) **68**
Command Information **81**
ComPsych **109**
Continental (CAL) **84**
Corzen **14**
Creative (CREAF) **56**
Credit Suisse (CS) **46, 56**
CVS (CVS) **94**
Cyberonics (CYBX) **30**

D
DaimlerChrysler (DCX) **13, 44**
Dell (DELL) **56**
Delta (DALRQ) **18, 84**
Deutsche Bank (DB) **13, 46**
Deutsche Börse **30**
Dewar's **54**
Disney (DIS) **42, 138**
Dividend Capital **36**
Dogster **40**
Dow (DOW) **132**
D. Porthault **110**
Duane Reade **94**

E
Edmunds.com **13**
Edwards Lifesciences (EW) **132**
Emanuel Ungaro **110**
Endpoint Technologies **56**
Equity Office Properties (EOP) **30, 36**
E*Trade (ET) **10**
Euronext **30, 46**
E.W. Scripps (SSP) **30**

F
Facebook **40**
Falesco Winery **122**
Federated (FD) **13**
Federated Investors (FII) **16**
Ferragamo **110**
Fidelity **124**
Ford (F) **13**
Fox (NWS) **30**
Freeport-McMoRan (FCX) **30**
Frisco Financial **124**
Fujitsu (FTJSY) **68**

G
Gabelli Global (GGT) **132**
GE (GE) **50, 142**
General Growth Properties (GGP) **35**
General Mills (GIS) **96**
Gillette (PG) **68, 96**
Giorgio Armani **110**
Global Crown Capital **42**
GM (GM) **13**
Goldman Sachs (GS) **38, 46, 56**
Google (GOOG) **14, 30, 42, 56, 68, 144**
Groove Networks **56**
GroupM **26**
Guardian Media **26**

H
HarperCollins (NWS) **30**
Harrah's (HET) **132**
HBO (TWX) **40, 68**
HCA (HCA) **30**
Hearst **14, 30**
Hitachi (HIT) **68**
HP (HPQ) **56**

I, J
IBM (IBM) **10, 16, 22, 106, 144**
Inamed (AGN) **30**
Intel (INTC) **68**
ITV **30**
Jaeger-LeCoultre **114**
Jefferies (JEF) **132**
JetBlue (JBLU) **84**
JohnandKiras.com **32**
JPMorgan Chase (JPM) **102**
Juicy Couture (LIZ) **68**
Jump Associates **50**

K, L
Kookmin Bank (KB) **48**
Korea Exchange Bank **48**
Korea First Bank **48**
Kraft Foods (KFT) **96**
Lanvin **110**
Lehman (LEH) **38**
Lenovo (LNVGY) **106**
LG **68**
LG Card **48**
L.L. Bean **32**
Lockheed (LMT) **132**
Lone Star Funds **48**
LSE **30, 46**
Lucent (LU) **106**
LVMH **110**

M
Macklowe Properties **30**
Macy's (FD) **84**
Manzanita Capital **110**
Marriott (MAR) **10**
MasterCard (MA) **68**
Matrix USA **132**
Mattel (MAT) **30**
Mavenir Systems **68**
McDonald's (MCD) **68**
MediaNews Group **30**
MediaVest **54**
Medtronic (MDT) **30**
Mentor (MNT) **30**
Mercedes (DCX) **13, 44, 116**
Merck (MRK) **132**
Merrill Lynch (MER) **46**
Mervyns **13**
MGA Entertainment **30**
MGM Mirage (MGM) **132**
Microsoft (MSFT) **20, 22, 56, 68, 106, 109, 144**
MobiTV **68**
Monster.com (MNST) **14**
Morgan Stanley (MS) **38, 42, 46**
Morningstar (MORN) **128**
Motorola (MOT) **50, 68**
MTI Micro (MKTY) **68**
MTV (VIA) **40, 54**
Multiply **40**
MySpace (NWS) **14, 30, 40**

N
Naroff **28**
NASDAQ (NDAQ) **30, 46**
Neiman-Marcus **32**
Newbridge Capital **48**
News Corp. (NWS) **26, 30, 40, 68, 142**
New York Times (NYT) **42**
Nickelodeon (VIA) **40**
Ning **40**
Nintendo (NTDOY) **22, 56**
Nokia (NOK) **68**
Nortel (NT) **50**
NPD Group **13**
NTT DoCoMo (DCM) **68**
NYSE (NYX) **30, 46**

O, P
Oak Hill Capital **94**
Openheimer **132**
Optimi **68**
Outcalt & Johnson **35**
Pacific Ethanol (PEIX) **42**
Palm (PALM) **68**
Patek Philippe **114**
PBD Worldwide **109**
Perella Weinberg **46**
Pfizer (PFE) **10, 132**
Phelps Dodge (PD) **30**
Philips Norelco **16**
Piaget **114**
Porsche **44, 116**
Porter Case **119**
PPR **110**

R, S
Raymond James **124**
Reader's Digest (RDA) **30**
Reckson (RA) **30**
RIM (RIMM) **68**
Ripplewood Holdings **30**
Rodman & Renshaw **132**
Royal Philips (PHG) **106**
Saks (SKS) **32**
Salesforce.com (CRM) **56**
Samsung **68, 106**
S & P (MHP) **94, 102**
Sanford C. Bernstein **96**
Sangamo BioSciences (SGMO) **132**
Segal **102**
Siemens (SI) **10**
Sirna Therapeutics **132**
Skype (EBAY) **68**
SkyRoll **119**
Smith & Hawken (SMG) **3**
Softbank **14**
Soleil-Media Metrics **42**
Sony **22, 56**
Sony Ericsson **68**
Spieker (SPK) **36**
Sprint-Nextel (S) **68, 81**
Strategy Analytics **68**
Strong Capital **16**
Sun (SUNW) **56**
Supervalu (SVU) **96**

T
Talbots (TLB) **32**
Telarc Records **120**
Telecom Italia (TI) **142**
Texas Pacific **132**
ThinkEquity **13**
Thomas H. Lee **30**
Thomson (TOC) **38, 94**
Time Warner (TWX) **38, 68, 142**
Tissot **114**
Tortoise North American Energy (TYN) **128**
Toshiba (TOSBF) **22, 68**
Toyota (TM) **44, 50**
Tribune (TRB) **132**
Tristate Holdings **106**
Trizec Properties (TRZ)

U, V
UAL (UAUA) **84**
Ubisoft (UBI) **16**
UBS (UBS) **46**
Universal Music **30**
Universum **106**
US Airways (LCC) **18, 84**
U.S. Trust (SCHW) **30**
Vanguard **124**
Veoh Networks **54**
Vera Bradley **119**
VeriSign (VRSN) **68**
Verizon (VZ) **68**
Victoria's Secret (LTD) **3**
Visa **68**
Volkswagen **44**

W
Warburg Pincus **48**
Western Airlines **84**
Westfield **35**
Williams-Sonoma (WSM)
Winebow **122**

X
XM Satellite (XMSR) **68**

Y
Yahoo! (YHOO) **14, 30, 4 56, 68**
Yankee Group **16**
YouTube **40, 54, 68**

Z
Zappos.com **32**

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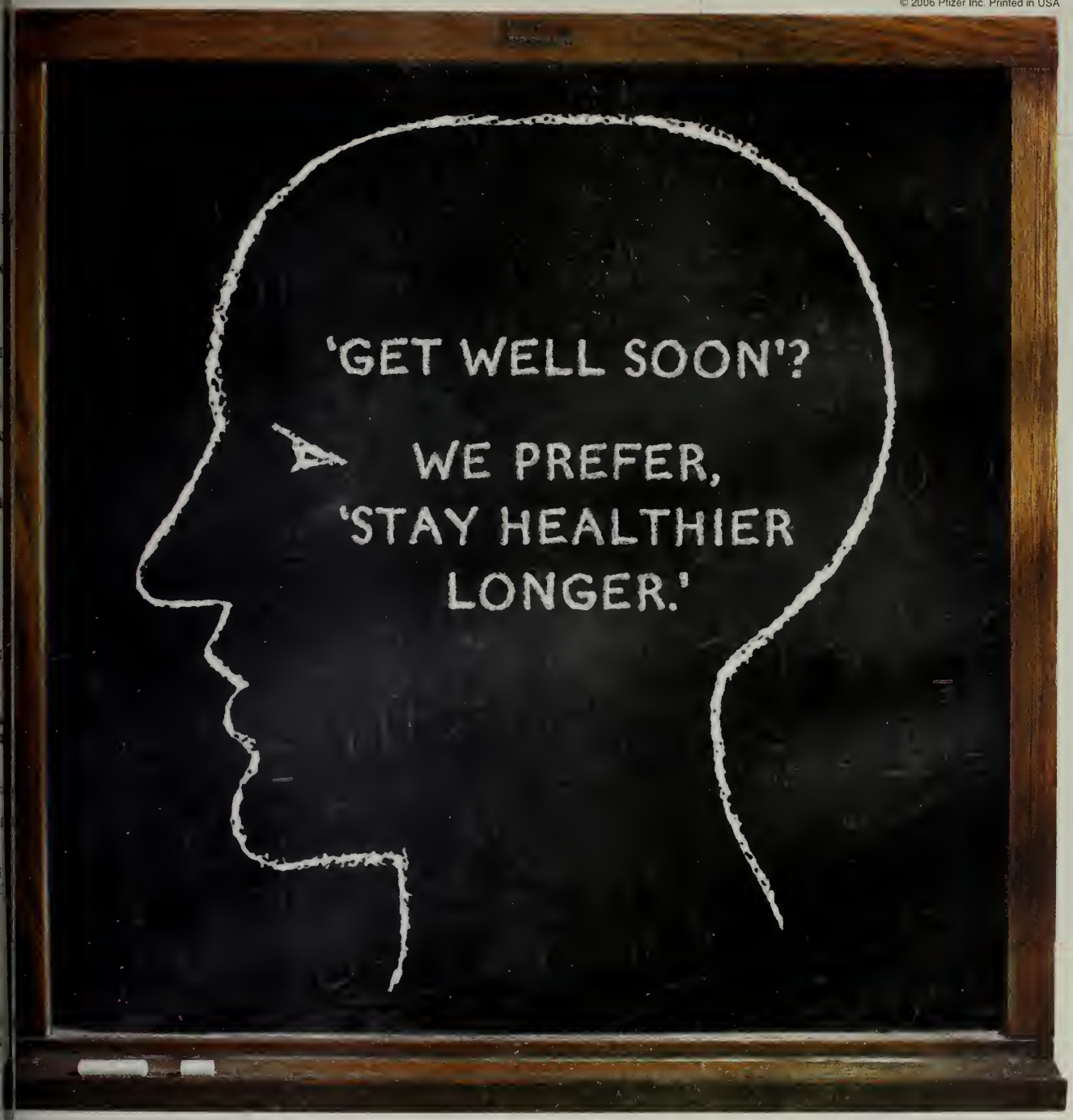

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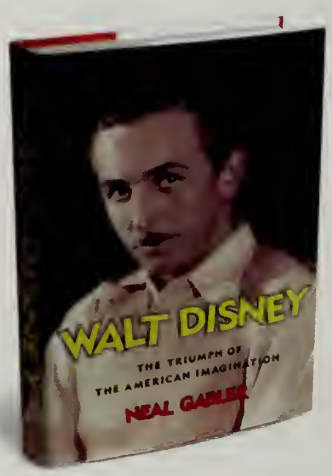
Walt's Not-So-Wonderful World

WALT DISNEY The Triumph of the American Imagination
By Neal Gabler; Knopf; 851pp; $35

To generations of Americans, he was the kindly Uncle Walt who visited each Sunday night via the television with tales of Davy Crockett or Donald Duck. But in 1941, Walt Disney was a hated figure at his own Burbank studio. When the Screen Cartoonists Guild gathered petitions to organize a union, the man who gave America Mickey Mouse and Snow White brought in armed guards to intimidate employees. He fired organizers, slashed pay, and even instituted austerity measures that included cutting hours at the coffee shop. On one occasion, when pickets gathered outside the studio gates, every parent's best friend charged from his Packard and had to be restrained from attacking the ringleader.

It is hard not to lionize Walt Disney. Perhaps no man has so changed popular culture or more embodied the American dream. He revolutionized the entertainment industry, both in creating the first cartoon that combined sound and picture and by using TV to promote a theme park that would become a national obsession. But in biographer Neal Gabler's impeccably researched if somewhat plodding *Walt Disney: The Triumph of the American Imagination*, a different picture of Disney also emerges—a distant and often despotic leader who became something of a figurehead, often dependent on others to turn out the later animated films that bore his name.



As described in 633 detail-crammed pages (supported by a stupefying 166 pages of footnotes), Gabler's Disney, the son of an emotionally distant father, tries desperately to create a fantasy version of his boyhood in the small town of Marceline, Mo. Yet he has difficulty connecting with his true-life family, even his brother Roy's newborn son. When Walt's father dies, he decides not to cut short a business trip to attend the funeral.

Gabler, whose résumé includes such brilliant Hollywood histories as *An Empire of their Own: How the Jews Invented Hollywood*, was given unusual access to Walt Disney Co.'s voluminous archive of Disney memos. From that he creates a rich narrative of Walt's world. It is a universe marked by profligate gambles and by the brilliant management of Walt's older brother Roy, who worked in the shadows to build and maintain a company that often operated on the edges of bankruptcy. When Walt went over-budget making *Snow White and the Seven Dwarfs*, Roy prevented Bank of America from shutting things down by shipping them a copy of what would soon win accolades as the first full-length animated film in color. But even Roy wasn't spared the wrath of Walt the two brothers frequently warred.

Gabler offers a workmanlike version of oft-told stories, such as how Disney conceived of Mickey Mouse while on a train ride back to California after a failed New York busine trip—and how Walt's wife, Lillian, made him ditch the rodent's initial name of Mortimer. We read how, with Roy's help, Walt funded Disneyland by swapping ABC an equity stake in the $17 million park in exchange for promised TV shows. The arrangement also had the happily synergistic consequence of promoting the amusement park to million television viewers.

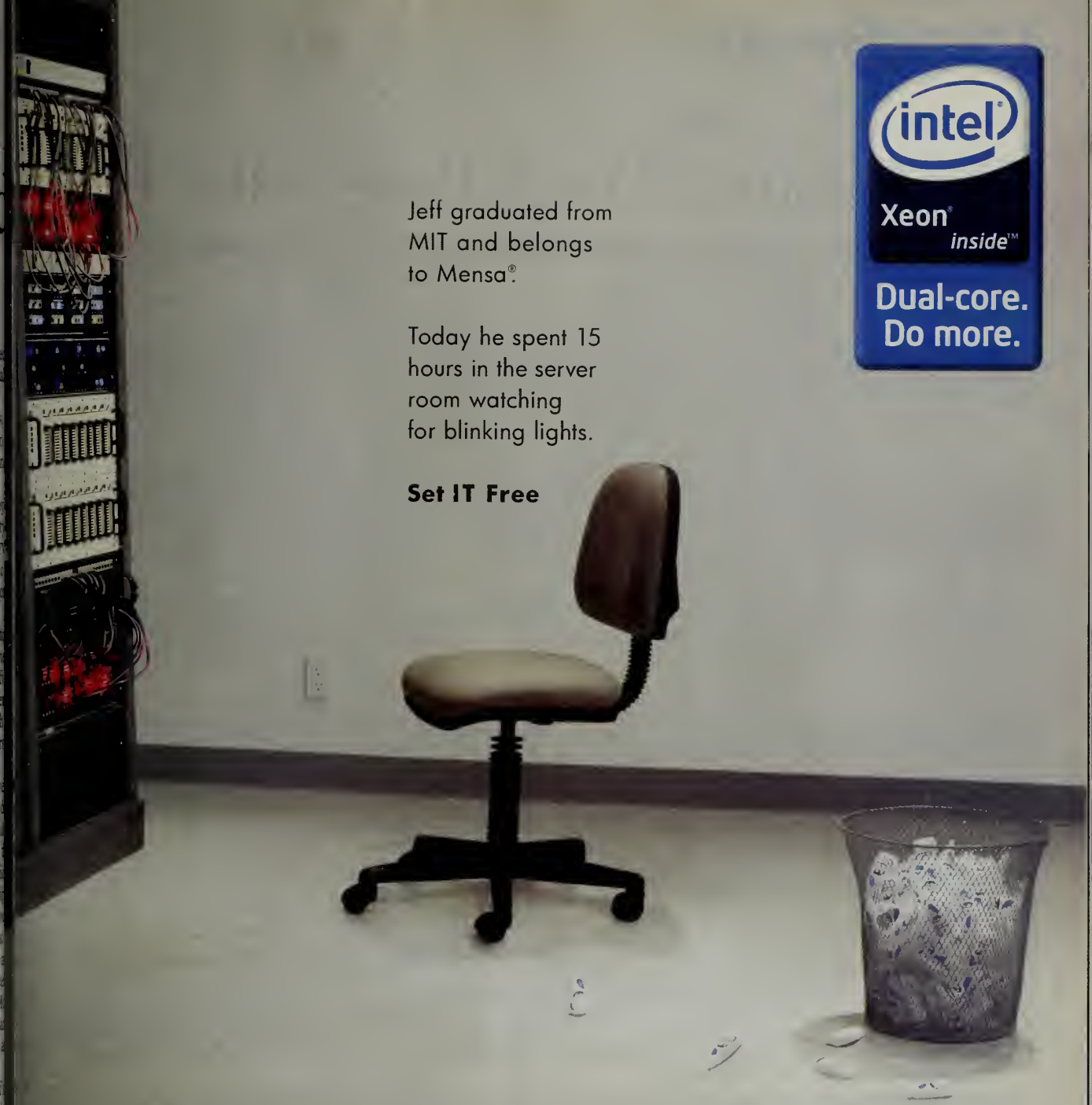
But Gabler's best work is in bringing to life the real Walt, who was never the same after a 1931 breakdown at age 29 that left him emotionally fragile. Often despondent he would retreat to his home to play with t trains. At the office, he terrorized workers with harsh criticisms as he impatiently drummed his fingers. Gabler doesn't dwell on well-known allegations, such as the ide that Disney was a racist (he thought hiring African Americans would "have spoiled th illusion at Disneyland") and anti-Semitic (reputation due largely to his membership an executive organization that was famous hostile to Jews). More attention is paid to l anger toward union activists, including an account of how he contacted FBI and the red-hunting Hou Committee on Un-American Activities to finger several as Communists.

Often despondent, Disney would stay home and play with toy trains

The author's account of h Disney's films were made is mind-numbing in its detail. Better is a description of how Walt, who last drew a cartoo 1929, basked in the myth of h own creativity while becomi dependent upon an empire c smart artists and functionari When the producer of *The Mickey Mouse Club* picked boyi sandy-haired Jimmie Dodd as a host for the show, he invit the young singer to a meeting he knew Walt was attendin "We've got to let Walt discover you," the producer said.

Still, "arguably no single figure so bestrode American culture as Walt Disney," writes Gabler. The man from Marceline enchanted millions of children throughout the world. But as Neal Gabler makes painfully clear, Walt Disn own adulthood was far from magical. ■

–By Ronald Gr



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The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS

		LAST MONTH	MONTHS ON LIST
1	**WHY WE WANT YOU TO BE RICH** Donald J. Trump, Robert T. Kiyosaki, Meredith McIver, Sharon Lechter (Rich Press • $24.95) *Some guys got it, some guys ain't.*	–	1
2	**THE WORLD IS FLAT** Thomas L. Friedman (Farrar, Straus & Giroux • $30) *Globalization is great—sort of, says a columnist for* The New York Times.	1	18
3	**FREAKONOMICS** Steven D. Levitt, Stephen J. Dubner (Morrow • $27.95) *Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.*	2	19
4	**BLINK** Malcolm Gladwell (Little, Brown • $25.95) *Snap judgments deserve careful consideration, says a writer for* The New Yorker.	3	22
5	**TOUGH CHOICES** Carly Fiorina (Portfolio • $24.95) *The former Hewlett-Packard CEO on her life and career.*	–	1
6	**THE LONG TAIL** Chris Anderson (Hyperion • $24.95) *The mass market featuring the blockbuster product is giving way to a "mass of niches."*	4	4
7	**THE LITTLE BOOK OF VALUE INVESTING** Christopher H. Browne (Wiley • $19.95) *How Graham and Buffett did it.*	–	1
8	**JIM CRAMER'S REAL MONEY** James J. Cramer (Simon & Schuster • $26) *Trading tips from CNBC's wild man.*	6	19
9	**MAKE MONEY NOT EXCUSES** Jean Chatzky (Crown Business • $24.95) *Women, too, can succeed at investing.*	9	2
10	**SETTING THE TABLE** Danny Meyer (HarperCollins • $25.95) *A New York restaurateur tells how he thrived in a ruthless business.*	–	1
11	**LITTLE BLACK BOOK OF CONNECTIONS** Jeffrey Gitomer (Bard Press • $19.95) *Building relationships with customers, co-workers, vendors, etc.*	5	3
12	**BEYOND BASKETBALL** Mike Krzyzewski with Jamie K. Spatola (Warner Business • $17.99) *Duke's roundball coach on winning, losing, sportsmanship, etc.*	–	1
13	**THE ONE MINUTE MANAGER** Kenneth Blanchard, PhD, Spencer Johnson, M.D. (Morrow • $19.95) *Three management techniques conveyed in brief story form.*	8	18
14	**OUR ICEBERG IS MELTING** John Kotter, Holger Rathgeber (St. Martin's • $19.95) *The eight steps penguins need to deal with change.*	11	2
15	**MAVERICKS AT WORK** William C. Taylor, Polly LaBarre (Morrow • $26.95) *Profiles of nonconformist business leaders and their creative tactics.*	–	1

PAPERBACK BUSINESS BOOKS

		LAST MONTH	MONTHS ON LIST
1	**GOOD TO GREAT AND THE SOCIAL SECTORS** Jim Collins (Collins • $11.95) *A primer on how noncorporate organizations can excel.*	1	1
2	**WHAT COLOR IS YOUR PARACHUTE? 2007** Richard Nelson Bolles (Ten Speed Press • $17.95) *The enduring job-search bible.*	2	
3	**LEADERSHIP AND SELF-DECEPTION** The Arbinger Institute (Berrett-Koehler • $14.95) *A leader's motivation is what matters, says this business fable.*	4	
4	**A GUIDE TO THE PROJECT MANAGEMENT BODY OF KNOWLEDGE** Project Management Institute (PMI Publications • $49.95) *Delivering results.*	3	
5	**COLLAPSE** Jared Diamond (Penguin • $17) *From Easter Island to Central America, why civilizations fall apart.*	10	
6	**THE INTELLIGENT INVESTOR, REVISED EDITION** Benjamin Graham, with Jason Zweig (HarperBusiness • $19.95) *The classic treatise on "value investing."*	8	
7	**THE SEARCH** John Battelle (Portfolio • $14.95) *The history of Internet search technology, and especially of Google.*	–	
8	**RICH WOMAN** Kim Kiyosaki (Rich Press • $18.95) *How women can take control of their finances.*	9	
9	**FIND IT, FIX IT, FLIP IT!** Michael Corbett (Penguin • $15) *How you can profit from real estate, by a TV show host.*	6	
10	**THE AUTOMATIC MILLIONAIRE** David Bach (Broadway • $12.95) *How you can put your investment program on autopilot.*	7	
11	**THINK AND GROW RICH** Napoleon Hill (Ballantine • $7.99) *Willpower and a positive attitude are the keys to achieving wealth.*	11	
12	**THE LEADERSHIP CHALLENGE** James M. Kouzes, Barry Z. Posner (Jossey-Bass • $22.95) *The core concepts of leadership, with case studies and plans for action.*	14	
13	**WHAT IS LEAN SIX SIGMA?** Mike George, Dave Rowlands, Bill Kastle (McGraw-Hill • $12) *The "four keys" of the management system.*	–	
14	**THE ART OF POSSIBILITY** Rosamund Stone Zander, Benjamin Zander (Penguin • $15) *Rethink your life, by a therapist and a symphony orchestra conductor.*	–	
15	**DICTIONARY OF REAL ESTATE TERMS** Jack P. Friedman, Jack C. Harris, J. Bruce Lindeman (Barron's • $13.95) *Basic concepts defined.*	12	

LONG-RUNNING BEST-SELLERS

HARDCOVER BUSINESS BOOKS

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NOW, DISCOVER YOUR STRENGTHS Marcus Buckingham, Donald O. Clifton (Free Press • $30)
THE FIVE DYSFUNCTIONS OF A TEAM Patrick Lencioni (Jossey-Bass• $22.95)
THE LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Bard Press • $19.95)
WHO MOVED MY CHEESE? Spencer Johnson (Putnam • $19.95)
FISH Stephen C. Lundin, Harry Paul, John Christensen (Hyperion • $19.95)
EXECUTION Larry Bossidy, Ram Charan (Crown • $27.50)

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RICH DAD, POOR DAD Robert T. Kiyosaki with Sharon L. Lechter (Warner • $16.95)
THE TIPPING POINT Malcolm Gladwell (Back Bay • $14.95)
THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE Stephen R. Covey (Free Press • $15)
GETTING THINGS DONE David Allen (Penguin • $15)
GETTING TO YES Roger Fisher, William Ury, Bruce Patton (Penguin • $15)
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RICH DAD'S CASHFLOW QUADRANT Robert T. Kiyosaki w Sharon L. Lechter (Warner • $17.95)
RICH DAD'S GUIDE TO INVESTING Robert T. Kiyosaki with Sharon L. Lechter (Warner • $19.95)
THE MILLIONAIRE NEXT DOOR Thomas J. Stanley, William Danko (Pocket Books • $15)
BUILT TO LAST James C. Collins, Jerry I. Porras (HarperBusiness • $17.95)
THE 48 LAWS OF POWER Robert Greene (Penguin • $18

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Romano Prodi Opens Up

SINCE HE WON ELECTION last April by a narrow margin over Silvio Berlusconi, Italian Prime Minister Romano Prodi has made more waves than a powerboat in Venice. As a former Prime Minister and former president of the European Commission, he is no stranger to global politics. But Prodi remains outspoken. In September, he found himself in the middle of a business blowup after Telecom Italia Chairman Marco Tronchetti Provera resigned amid accusations that he had misled Prodi about the direction of the company.

You beat Silvio Berlusconi by a small margin. Do you feel you have a mandate to lead?
Did the President of the U.S. have a mandate to lead? His margin was even smaller. When you win, you win.

How are you planning to jump-start the sluggish Italian economy?
I already started. Italy, in my opinion, has a group of corporations that are strong but separate from others because of special privileges.... So I've started to break this up. And I shall work step-by-step [to create] more competition. [Also,] tax evasion is at indecent levels. How can you run an economy if all the weight is on the shoulders of 60% of the population, and the others don't pay?

There is increasing discontent in the European Union. How is it possible to have one central bank and one currency for such different economic stories?
This is what I repeated for years and years. It's very simple: Monetary policy without some sort of economic policy may be dangerous.

There has been speculation that your government pushed out the chairman of Telecom Italia because you did not agree with his restructuring plan.
That is completely, completely, completely untrue. This was something very unfair.... Tronchetti Provera asked for appointment with me. He didn't tell me about all of the ferent things he was working on. Then he announces this decision [to possibly split Telecom Italia Mobile from Telec Italia and sell it]...you know, to give the idea that the gov ment had known about it. I didn't know anything about w Tronchetti decided—and I didn't say no or yes to his decis But I said if you call your Prime Minister and ask for a mee with him, you must tell the truth.

Did you exert political pressure on Telecom Italia to adopt a different business plan?
No, 100%.

Did you release inside information about whom Telecom Ita was talking to [said to be News Corp., GE, and Time Warner
Never. Never. When? When? I sir said that I was astonished [by the c sion to sell the mobile unit]. But body would be astonished....

A STATE STAKE? Prodi hints Italy may want a piece of Telecom Italia

Will the government take a stake in Telecom Italia again? Some might view that as a step backwards towar nationalism.
[Before the blowup] the situation absolutely stable. And so there wa plan by government because there no need for a plan. Of course, after event, you have to think it over.

Telecom Italia Mobile is the last of Italy's four mobile networks still in Italian hands. Are you trying to kee that way?
I am not nationalistic. If it goe foreign hands, I am sorry. But that's life. The same goe banking and so on. But while I want to run a modern cou a country open to the markets, I don't want always tha companies are bought by foreigners. Sometimes bought sometimes buying.

Whether it is banks or telecom, do you sense a renewed nationalism and protectionism?
I don't think we have demonstrated ourselves to be a cl country. What [we need]...are energetic entrepreneurs w ing within a clean system.... We can be leaders in Europ

Maria Bartiromo is the host of CNBC's Closing Bell.

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fter moving around he world, Jay Jordan is njoying the ride in Ohio.

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JAY JORDAN'S STORY

"For quality of life, Ohio takes a backseat to no place we've lived."

Jay Jordan
President and CEO
Online Computer Library Center

In 1998, Jay Jordan moved to Ohio from Denver to become just the fourth president in the 39-year history of the Online Computer Library Center (OCLC). With more than 55,000 libraries in 110 countries using its services, OCLC is the world's largest library cooperative. It was also recently named to *Computerworld* magazine's list of "100 Best Places to Work in IT."

Since coming to Ohio, Jay has been pleased by the business-friendly environment and diverse, skilled talent pool that's critical to OCLC. Yet he's been most impressed with the collegiality of the business community. Ohio CEOs network and collaborate far beyond anything Jay has seen elsewhere. Business leaders get truly involved in helping and mentoring startup businesses.

Having lived in the Northeast, on the West Coast and in three European countries, Jay and his wife, Mary, have discovered that Ohio is much more sophisticated than outsiders may believe, having all the city amenities you'd want plus a variety of pleasant surprises. Jay finds the golf to be particularly outstanding and enjoys polishing his game on Ohio's many world-class courses.

Ohio has been a great move for the Jordans.

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BY JACK AND SUZY WELCH

Don't Play the Office Cop

What can you do about a peer who persistently disrupts work? This person is no problem for the bosses but butts heads with practically every "lateral" member of the team.

–Ashley Prisant, Cambridge, Mass.

You've got a real problem—a brutal and all-too-familiar one—but unfortunately one you probably can't solve. Peers don't manage peers; they have some influence, but no power. So understand that if you try to take on this disrupter on your own, you enter the fight unarmed.

Yes, you can pull disrupters aside for a conference room chat, take them out for a long lunch, or write a thoughtful letter. But no matter what evenhanded approach you use, the response will probably be in the same vein. "You don't understand," disrupters will tell you, "I'm trying to save the business." Or, "if you had my experience you'd see why I'm right." Or, "why are you so competitive with me?"

Now, we're not talking here about good, old-fashioned skeptics, who actually play an important role by prodding the organization to challenge itself at every turn. While sometimes cranky and unpleasant, many do care about the company. They don't pick fights for sport; they're just slow to persuade, and they're that way with everyone, bosses included.

> It's a losing battle to confront a troublemaker at work if you're not in authority

Disrupters, by contrast, cannot be convinced about anything, or be reasoned with, for that matter. There's something else going on in their psyche, something that does not allow them, for lack of a better phrase, to play nicely with others. Therefore, unless you're a psychiatrist, your best bet is just to keep as much distance as possible.

Just as important, keep your mouth shut and your head down. Wait for your boss or HR to identify and fix the problem, which will eventually happen if you picked your company right. Indeed, given that you have some level of respect for management, if there was any time to trust the organization, it is now.

Incidentally, this advice has already been met with disagreement. When this question was asked of one of us (Jack) during a class session at MIT's Sloan School of Management, a group of students strongly advocated the "long lunch" approach mentioned above. They made the case that peers have a responsibility to the team to work out their own problematic dynamics. They shouldn't wait for a "whi knight" from upstairs to save them from themselves.

We'd say this view is commendable. But in our experien it's an unlikely fix. Peers are up against a lot when trying tc police peers, especially when one's an outlaw.

With today's increasingly mobile workforce, what's a manage to do to retain employees?

–Claudia Stowers, Philadelp

You are so right. Gone are the days when companies had employees who signed up at 21 and marked time until retirement. Back then, people wanted to stay put. They bought homes with the proverbial white picket fence, had kids, and joined a few community clubs. An uninterrupted career with one company completed the picture.

That lifestyle has been eroding for decades now. Two or three job changes in one decade are not unusual. That ma good for a person's career building, but it's not particularl good for companies. Every time talented, productive employees walk out the door, they take with them training and experience. They're investments with unrealized retu

Given that, companies must have powerful retention mechanisms in place. Unfortunately, too many don't, and we're not talking about competitive compensation progra Money is Basic Retention 101.

No, retention starts with senior management's giving the matter real bite. It has to be an organizational sin to lose a top-20 performer. It just cannot happen without repercussions. That makes it imperative for companies to have rigorous appraisal systems in place, so they know exactly who their best are and can manage and reward them accordingly. It also demands that leaders at every le constantly create excitement in their groups. They need tc aspirational, explaining why the team's mission is import and inspirational, talking frequently and personally with performers about their individual routes to success.

The ultimate retention tool, though, is success—profitab growth, and opportunity. Those three "little" reasons are w great people didn't leave IBM in the '70s or Microsoft in th '80s. And they're why high performers aren't leaving Goog now. Your company may not be as successful as Google, bu every time you give it some sizzle, your increasingly mobile workforce will stop running for the train. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekl podcast, go to www.businessweek.com/search/podcasting.htm.*

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Special Report

60 Smashing the Clock No fixed schedules. No mandatory meetings. Work whenever, wherever—just get it done. Best Buy has embarked on a radical experiment to transform a culture once known for killer hours. So far, productivity is up

64 The New Flextime Rethinking work-life balance

GLOBAL BUSINESS

52 China's Global Capitalist Yang Yaungqing has made an improbable journey from the Cultural Revolution to chairman of Lenovo. Now, with IBM's PC business in hand, he is turning the computer maker into a new breed of multinational. Welcome to the future

CONTENTS

Economics

31 The Business Outlook
Jim Cooper says capital spending should pick up again soon. But harder times may lie ahead for hard-hat workers

InfoTech

71 The eBay Model Goes to the Movies
InDplay, a startup with a Silicon Valley pedigree, is launching a Web site to connect buyers and sellers of film licensing rights

72 NetSuite's Coming-Out Party
After eight years, the Larry Ellison-backed business-software startup may finally go public

Entrepreneurs

76 Rubbersidewalks: Trees Love It
Lindsay Smith's fast-growing company got its start when she was trying to save foliage in her California town

Science & Technology

78 When a Winner Starts to Wane
Endo Pharmaceuticals has a habit it needs to kick: It's too dependent on Licoderm, its best-selling pain patch, which may have competition sooner than it expected

82 Off-Label Whispers Grow Louder
Some medications are quietly—and profitably—marketed for ailments not approved by the FDA

Architecture Awards

84 Designed for Success
From an Apple Store to a research lab, the winners of this year's *BusinessWeek/Architectural Record* Awards display a lot more than just a pretty facade

Executive Life

90 Finely Tailored Vacations
"Bespoke" agencies will design personalized, off-the-beaten-path trips even on short notice. But they're pricey

Personal Finance

96 The Science of Smart Giving
Squeezing the most good from large-scale donations takes serious planning. Here are five success stories

98 A New Way to Beat the Market?
So-called 120/20 mutual funds use both short sales and leverage

100 Inside Wall Street
Gene Marcial's stocks to watch

101 Figures of the Week

Columnists

24 Steve Wildstrom: Tech & You
Bringing cell-phone and e-mail serv to older people who are tech-challen

28 Jon Fine: Media Centric
YouTube and its new owner Google offering to pay traditional media wh they're calling licensing fees

94 Parker On Wine
Domaine de la Moldorée represents essence of Provence—and its grapes organically or biodynamically farme

112 Jack and Suzy Welch: The Welch
How to let your company grow up b stay young

Ideas

106 Books
Kahaner: *AK-47: The Weapon That Changed the Face of War*

110 Outside Shot
Newt Gingrich and Robert Egge: L Pay Up for Alzheimer's

Features

13 UpFront
20 Readers Report
22 Corrections & Clarifications
104 Index to Companies

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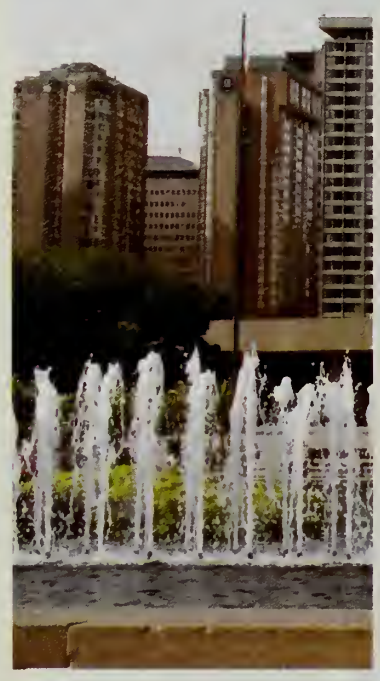

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Tis the season—for draining your bank account to buy presents for the special people in your life. But finding the right gift can be a labor-intensive process. Visitors to BusinessWeek.com shouldn't have that problem if they take the time to check out o **2006 Executive Gift Guide.** This year we offer readers a wide range offerings at prices to fit every budget. Ea of the 11 gift guides, which cover everyth from books to apparel to consumer electronics to wine, feature items that sta at **under $25** and go up to **more than $10,00** Have a car buff in your life but don't war to spend a fortune? How about the PNI Silver Bullet Radar Detector for $149.95 For the connoisseur of **fine libations,** what could be better than a beautifully design bottle of cranberry-infused vodka for as little as $25? Of course, we offer plenty of **big-ticket items,** too, for those really special someones. How special? How about **a one-week stay** at California's Golden Door spa for $7,750 or a case of 2000 Château Haut-Brion for $6,6 That's what we call getting into the holiday spirit. For all this more, go to **www.businessweek.com/slideshows/ss_giftguides.htm.**

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is the SINGLE MALT *that*

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UP Front

"It seems like it's the end of an arms race."

–Michael Krensavage, an analyst at Raymond James Financial, on Pfizer's decision to lay off 20% of its sprawling U.S. salesforce, as reported in The New York Times

TED BY DEBORAH STEAD

ARTUPS

HE NAPSTER D TURNS TO ARCRAFT

WN FANNING, the 26-year- founder of **Napster**, has a passion: online gaming. r transforming music industry his file- ring site and running into ys in launching usic-licensing ture, he's in the tup business in. In a month or he told *BusinessWeek*, introduce **Rupture**, a al social community for ne gamers. the past year and a half, ning has been glued to ld of Warcraft, an online fantasy game played by 7.5 million people, and he's frustrated with how hard it is to communicate with other players. That's where Rupture comes in. The service, which will be ad-supported, taps into the game via a software download to help Rupture members play the game and learn about one another—character names, profiles, game stats. The personal data will be in a **Facebook**-like page, and members can chat via instant messaging while playing. Is there a market for Rupture? **Viacom** this spring bought **Xfire**, a less sophisticated chat service for gamers, and **Microsoft** plans to add more community features to its Xbox.

FANNING

–Heather Green

THE BIG PICTURE

MERGERS are heating up again. And surprise! Many CEOs will get rich payouts if their companies are bought, according to a new dy of merger payout provisions at 200 publicly traded companies.

RCENT OF CEOs WHO WILL GET...	
sh payments equal to at least three times ir annual pay	63%
sh payments if they lose their jobs a result of a deal	81%
celerated cashing in of options and tricted stock even if they keep their jobs	79%
ditional money ("gross ups") to pay me or all of the taxes owed on their payout	68%

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IPOs

A Peek Into the Hedges

U.S. HEDGE FUNDS, those secretive investment vehicles, may be stepping into the sunlight. On Nov. 9, **Fortress Investment Group** said it will sell a 10% stake in a first-of-its-kind U.S. offering worth an estimated $750 million. The Fortress IPO may be just the start, says Donald Putnam, founder of **Grail Partners,** an advisory merchant bank.

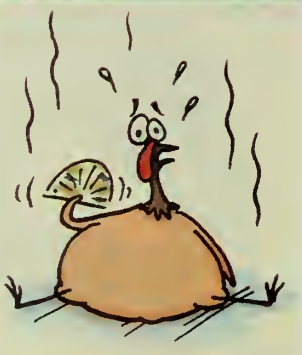
Putnam says the underwriters of the IPO have given presentations to dozens of the top 100 hedge funds. And "if the Fortress deal goes through, I think there'll be 30 hedge fund IPOs in the next 18 months," he predicts.

Already, some top European hedge funds have taken the plunge and found the market receptive. Switzerland-based **Partners Group** went public on Mar. 23, with shares up 80% since. And shares of **RAB Capital,** which trades on the London Stock Exchange, are up almost 69% so far this year.

A successful Fortress IPO "will pique a lot of interest," adds Eric Weber, a managing director at New York M&A adviser **Freeman**. Still, going public, he notes, raises "issues about compensation and disclosures." So why float public shares? One reason: to use stock to lure the next generation of hotshot money managers as founders retire. As if the standard 20% cut of profits isn't compensation enough. *–Mara Der Hovanesian*

UPFront

BLOGSPOTTING



NOW THAT'S CUSTOMER SERVICE

From a Thanksgiving Day post on "Behind the Counter," a Wal-Mart employee's personal blog (http://bbcamerican.blogspot.com):

Some lady returned a thawed-out turkey today. Yes. A thawed-out turkey.

She was getting ready to start cooking when the family called. They were having car trouble and weren't going to make it into town....

So what did she do? She took the bird out of the sink, PUT IT BACK IN THE PLASTIC and put it in a Wal-Mart bag, dug the receipt out of the trash... and returned the turkey, two boxes of stuffing, some cranberries, the stuff to make pumpkin pies, green beans and a package of rolls.

She rolled into Customer Service with all the fixings for a Thanksgiving dinner and rolled right out with nineteen dollars and change....

And the next woman in line goes, "did she really return a thawed-up turkey?" Yeah, she did. Next.

COLLECTING

WHAT THE RICH ARE BUYING NOW

CHOP TOP TABLE by Marc Newson

HEDGE FUND managers and real estate moguls have been snapping up contemporary art at record prices. Now they are starting to fuel the market in 20th century design, especially limited edition high-end furniture. And the hottest place to buy these sculptural pieces? The upcoming **Design Miami** on Dec. 8-10.

This is the second annual show for the fair, affiliated with the popular Art Basel Miami Beach destination. And auction results earlier this year indicate that the design market is heating up fast.

A 1986 limited edition metal chaise by designer Marc Newson fetched $968,000 at **Sotheby's** in June—more than nine times the record $105,000 it brought at **Christie's** in 2000.

For sale at Design Miami will be objects such as Newson's futuristic Chop Top Table (above).

The fair's main sponsor this year is **HSBC Private Bank**, which courts the kind of well-heeled browsers who will be attending. Further evidence of 20th century design's current cachet among top executives and financial types: **Coach** President Reed Krakoff, Miami real estate developer Craig Robins, former Wall Street commodities trader Robert Rubin (not the former Treasury Secretary), and Greek industrialist Dakis Joannou are all collectors.

Financial highfliers "are starting to combine contemporary art and contemporary design in their collections," says New York design dealer Cristina Grajales. "They're diversifying."

Not all of them are bitin though. Hedge fund mana James Chanos of **Kynikos Associates** says he'll checki out Design Miami, but he already "has his hands full" buying contemporar paintings while he's in Florida. *–Reena J*

STRESS

IDLE HOURS ARE A PARENT'S NIGHTMARE

WORRIED ABOUT what your preteen or teenager is up to on weekday afternoons? Sounds like a case of PCAST (Parental Concern over After School Time). That's the term coined in a study to be released on Dec. 6 by **Brandeis University** and **Catalyst,** which studies women in the workplace.

The survey of 1,755 parents employed at top U.S. companies was sponsored by **Citigroup, Fannie Mae,** and **Pfizer.** It found that kids' after-school life is a major worry for working parents, says Catalyst's Susan Nierenberg, with the most stressed employees having children in grades 6 and up.

The worries transcend race, gender, and income categories, with parents more concerned about unsupervised daughters than unsupervised sons.

Not surprisingly, the le worried parents were tho with partners at home. St 1 in 20 working parents experiences extreme stre over the care of school-ag kids. And high PCAST lev the survey found, can lea to lower productivity, po quality work, and lower j satisfaction.

One solution, of cours to provide greater flexibi through child-care subsi telecommuting, or even allowing children in the office. Then again, havin one's adolescent interact regularly with the boss c cause another kind of ar *–Diane*

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TOY STORY

HOW MUCH WILL PARENTS PONY UP?

SHE WHINNIES when her mane is touched and turns her head when her name is called. **Hasbro** is testing the upper spending limits of mass market toy customers

with its FurReal Friends Butterscotch Pony, which goes for $299.

Butterscotch is the priciest item on the season's hot-dozen list compiled by *Toy Wishes*, an industry publication. (Other expensive toys on the list: **Nintendo's** new Wii system and **Lego** Mindstorms NXT, a programmable robot.)

The 3-foot-high stuffed horse, which can support an 80-pound child, has electronic sensors that allow a range of motions and sounds (including chewing noises as the horse mimics eating a plastic carrot).

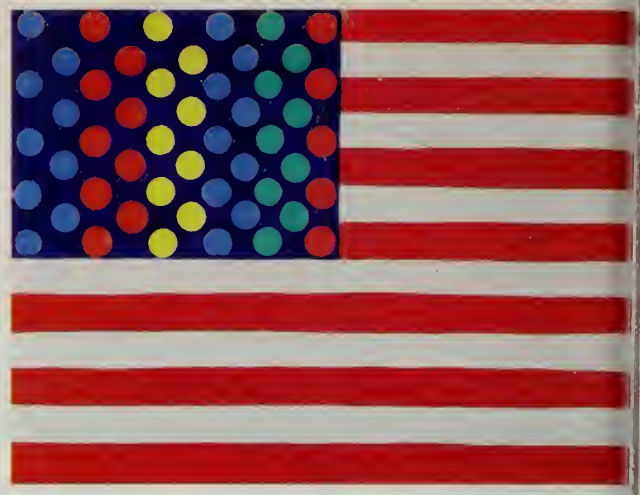
Sharon John, a Hasbro general manager, says Butterscotch is an attempt to think beyond the toy industry's usual pricing limits to capture a bigger share of the family budgets that regularly go to iPods and video game consoles.

BMO Capital Markets toy analyst Gerrick Johnson figures that given a choice between Butterscotch and the Wii system, many families will purchase the video game. Still, he says, stores are happy to stock the horse, since each Butterscotch sale brings in the same revenue as 62 of Hasbro's My Little Pony dolls. "The retailers have got to love it," he says.

Hasbro is heavily promoting Butterscotch on TV, and chains like KB Toys and Target are spotlighting her by putting her in a little corral surrounded by a white picket fence.

And some retailers are hitching a ride. **Toys 'R' Us** has been positioning its house brand Animal Alley Jumbo Horses prominently nearby. They lack the electronics, and kids can't really sit on them. But they cost only $59 apiece. All's fair in the toy wars at Christmas.

–Christopher Palmeri



FOUND ART

YOU'VE HEARD of impressionism, pointillism and surrealism. Now get ready for googlism. German painter C.S. Bernays has created an oeuvre based on Google's trademark colors and spheres. A heavy Google user, Bernays, 36, says the idea came to her last spring, wh "all of a sudden I saw the four spheres and fo colors." She's painted roughly 150 googlistic pieces—works that reference the history of art, from cave painting to Jasper Johns. No word yet on sales of the paintings, offered at www.kunstkopie.de only since November. But Bernays, who works near Hamburg, say Googling has established that no one else is selling anything similar. *–Jack Ew*

ge of W.B. Yeats, poet and Nobel Prize winner,
Louis le Brocquy.

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EDUCATION

VOUCHERS FLUNK THE MIDTERMS

IT LOOKED like The Year of the Voucher. From the beginning of 2006 through midsummer, eight states passed or expanded school choice programs. And notwithstanding free-market champions such as the late Milton Friedman, the movement had heavy bipartisan appeal: Democratic governors signed voucher measures or allowed them to pass without signature in Arizona, Iowa, Pennsylvania, and Wisconsin. As late as August, Dan Lips, an education analyst at the conservative Heritage Foundation, called 2006 "a breakthrough year for school choice."

But in the midterm elections, school choice quietly flunked out. Despite being heavily outspent, opponents of vouchers, tuition tax credits, and similar measures scored victories in several hotly contested states.

That was due in part to the political muscle of the teachers' unions, and in part to the lingering fears of many parents that vouchers would siphon tax dollars away from public education. "We got out the message that vouchers drain money from the schools," says National Education Assn. lobbyist Merwyn Scott.

The setback for vouchers comes as courts are divided on the use of public funds for private schools. Last January, the Florida Supreme Court said a voucher program backed by Governor Jeb Bush was unconstitutional. But the Wisconsin Supreme Court has allowed vouchers for programs like Milwaukee's CEO Leadership Academy, a religious school.

The election, however, mostly went against school choice. In South Carolina, the Republican candidate for education superintendent lost to a strong opponent of tuition tax credits, failing to ride the coattails of GOP governor Mark Sanford, who supports credits and won reelection. Anti-voucher candidates also won in the Texas House of Representatives. And in Utah, voucher opponents may have a bigger majority in the newly elected legislature than the last session despite some high-profile wins by voucher advocates. The battles weren't strictly partisan. In several primary elections anti-voucher Republicans defeated pro-voucher Republicans.

MILWAUKEE The CEO Leadership Academy will soldier on

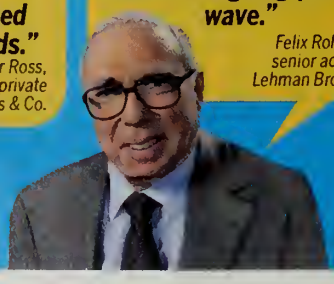
The movement also lost support in Congress, where an Administration-supported bill aims to create an experimental, $100 million federal voucher program. Does the legislation stand a chance now? Lips of the Heritage Foundation says that "the makeup of the new Congress casts doubt" on that. *–Peter*

QUESTION OF THE WEEK

How long will the current wave of megadeals last? And is a spate of hostile takeovers next?

"As long as interest rates are low, there'll be ever-bigger deals. Less likely in megadeals will be an LBO followed quickly by an IPO. I don't think investors will tolerate that in a giant company. As for hostile deals, look at the number of uninvited private-equity bids."

Wilbur Ross, chairman and CEO of private investment bank W.L. Ross & Co.



"There really are several distinct waves, all pushed partly by globalization's higher profits and cheaper capital. The private-equity movement is one of the most powerful. But it's not a merger wave. It's a going-private wave."

Felix Rohatyn, senior adviser, Lehman Brothers

"I don't think it's going to end anytime soon. There's a lot of private equity, and those managing it see a lot of poorly run companies. Separately, hostile takeovers are here to stay. Weak managers are always targets."

T. Boone Pickens Jr., chairman, BP Capital

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"Innovation needs to be...maintained.... Otherwise, we will be eating the exhaust fumes of China and India."

–David D. Kilpatrick
Sequim, Wash.

TELECOM ITALIA: ROMANO PRODI RESPONDS

IN REFERENCE TO the article by Maria Bartiromo ("Romano Prodi Opens Up," Face Time, Dec. 4), may I point out that Professor Romano Prodi never intended to refer to a plan by the Italian Government to take an ownership stake in Telecom Italia.

In addition, the fact that the article appeared nearly 10 weeks after the interview between Professor Prodi and Ms. Bartiromo should have required an updated record at this late date to avoid this unfortunate misinterpretation.

–Silvio Sircana
Spokesperson for Romano Prodi
Prime Minister of Italy
Rome

WHAT GOVERNMENT POLICY CAN AND CAN'T DO

MICHAEL MANDEL OFFERS important insights into the limitations of national economic policy in a global economy ("Can anyone steer this economy?," Cover Story, Nov. 20). However, his identification of Paul Romer as the person who suggested first, in the 1980s, the Big Idea that innovation is important to the economy is way off the mark.

Romer's New Growth Theory is an i portant contribution, but the importa of technological innovation and chang the economy was recognized decades fore Romer. Robert Solow's 1957 paper the subject earned him a Nobel Prize economics. The book *Technological In vation for a Dynamic Economy*, which I edited with James Utterback, is only of many treatments of the relationshi innovation to economic performance t appeared well before Romer's work.

–Christopher T.
Professor of Public Policy & Technol
George Mason Univer
Arlington,

THE BASIC DYNAMICS of innovati growth linkages were first emphasize Joseph Schumpeter and Karl Marx s 94 to 158 years ago. They were h lighted econometrically during the 19 by Robert Solow, Jacob Schmookler, Solomon Fabricant. Detailed anal were provided during the 1960s by eral economists, including Schmoo Zvi Griliches, Richard Nelson, Ed Mansfield, Christopher Freeman, liam Nordhaus, and Edward Denison

That the U.S. enjoyed a compar advantage in international trade

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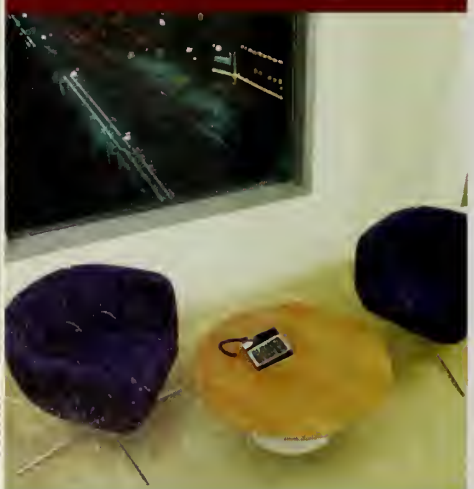

ReadersReport

innovation was shown in two February, 1967, articles, written inter alia by the leading scholar on multinational enterprise, Raymond Vernon.

Innovation has long been recognized as crucial for economic prosperity. The intellectual history should be characterized accordingly.

–F.M. Scherer
Professor Emeritus
John F. Kennedy School of Government
Harvard University
Cambridge, Mass.

INNOVATION POLICY IS miscast as one of the four big ideas of economic policy. Rather, innovation is the solitary big idea of cultural policy. Innovation needs to be understood and programs maintained to achieve it. Otherwise, we will be eating the exhaust fumes of China and India.

There has been a steady stream of innovations since 1800, including the steam engine, cotton gin, electric light bulb, Bessemer furnace, and the interstate highway system, for example. Each of these developments changed the culture and the economy, but none were mere "economic policy" implementations.

Government programs are important in maintaining an economic environment in which innovators find it worthwhile to innovate and capitalists find it worthwhile to support them. Quality education is imperative to the production of a population capable of innovating.

–David D. Kilpatrick
Sequim, Wash.

MANDEL SAYS the incoming congressional Democrats had better get used to government not being able to influence the economy and that "nobody" can figure out why real wages for Americans have fallen or how to ensure strong job creation and strong wage growth.

I would argue that government policies have been effective, but their goal was not higher U.S. wages and employment. Instead they focused on higher profits and higher incomes for the few at the expense of the many.

–John Reeder
Arlington, Va.

YOUR ARTICLE SHOULD have mentioned that spending on exports by our foreign trading partners is also a large share of the economy. The last time I checked, the U.S. was one of the top exporting countries on the planet. Mandel presents a hypothetical argument that foreign investors could pull out their money. But why would any seller intentionally cause financial harm to their best custome

–Bill Rausch
Hanover Park, I

EXECUTIVE PAY: DEFINE GOALS AND SEE IF CEOs MEASURE UP

BOARDS CAN'T communicate a comp ling rationale for CEO salaries becau few boards define their metrics ("CI pay: The prestige, the peril," Up Fro Nov. 20). Innovative companies that wa to be accountable for their CEO's sal should look at the company's reputati market position, strength, customer a employee satisfaction, and other fact that are critically important to the futu of the enterprise.

What if a board could say: "We paid CEO this many millions of dollars beca customer satisfaction went up, emplo satisfaction and retention went up, repu tion markers improved, and positions in key competitive markets strengthene Now that's a compelling message.

–Merrie Spa
Da

CORRECTIONS & CLARIFICATIONS

"Harvesting green power" (Special Repor Nov. 13) incorrectly stated that credits equal to the emission of 100 metric tons carbon were recently selling for $4.25. Credits equal to one metric ton of carbon were selling for $4.25. So a farm that sequestered 1,500 metric tons of carbon would collect nearly $6,400 in return.

"Don't wait till April" (Personal Finance, Dec. 4) incorrectly said that contribution to 529 plans are deductible from federal taxes. Contributions are not deductible, but withdrawals used to pay for educatio expenses are exempt from federal taxes.

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Tech&You

BY STEPHEN H. WILDSTROM

For Puzzled Seniors Only

Suppose I offered you a mobile phone that does nothing but make and receive calls. Or a printer that simply gets and prints e-mail messages. Sounds nutty, but this pretty much sums up the clever Jitterbug phone from GreatCall and the HP Printing Mailbox from Hewlett-Packard and Presto Services. Both meet real needs by doing very little.

The sweeping generalization that older people can't cope with today's technology is silly, but clearly there are seniors who are baffled and intimidated by computers and complicated phones. The Jitterbug and Printing Mailbox are for them. Both products sacrifice functions that you or I might consider essential, but what they offer in return is simplicity itself.

The Jitterbug Dial is a large Samsung clamshell phone. Buttons are big and clearly labeled. Text on the display is also large and easy to read. It has no menu button, since there are no menus, but it has a dedicated on-off button. A rubber gasket around the earpiece makes it more comfortable and helps exclude ambient noise. The Jitterbug even simulates a dial tone when it's ready for you to place a call.

Up to 15 names and numbers can be programmed into the phone when you order it, and more can be added by pressing 0 to reach a GreatCall operator. Press the up or down button, and the phone displays the contact list one name at a time and asks if you want to dial. Press "yes" to dial or "no" to go back to the contact list—or you can dial any number manually. The even simpler OneTouch version of this phone has just three buttons: One is custom-labeled and calls a prearranged number, the second places other calls through an operator, the third hangs up.

JITTERBUG DIAL

SERVICE PLANS ARE TAILORED TO THE NEEDS of light phone users. The Jitterbug costs $147 plus a $35 activation charge and $10 a month for a plan that provides only for emergency calling. You can buy a monthly calling plan starting at $15 for 30 minutes, or prepaid time in chunks of 100 minutes for $25. If you pay for a year's service in advance, you can get substantial discounts on the phone that increase with the number of minutes you buy.

The $150 HP Printing Mailbox, which is designed for people who do not have computers, goes even further in simplifying the other main mode of communication these days: e-mail. It's basically a low-end inkjet printer with a modem built in. To set up the service for an aging friend or relative, you enter the required information on Presto's Web site. The printer is assigned a presto.com e-mail address that is associated with the phone line to which it is attached. Based on a schedule that is decided during the setup, the printer dials Presto o or more times a day, with no human intervention, to retrieve and print any messages sent to the presto.com address, along with free daily or week newsletters or puzzles that you order.

Cell and e-mail services for older people who are tech-challenged

The Presto service, which costs $10 a mon or $100 a year, provide a tightly controlled environment. There's spam problem because the service will deliver only mail from a list of preapproved senders. The administrator of the mailbox can specify the type size used to print messages and even monitor ink and paper supplie via the Presto Web site.

Obviously, the fact that the recipient cannot rep to messages is a limitation. But this is a product designed for folks who just want to get pictures of the grandchildren (or more likely, great-grandchildren) and messages that can be answered, if necessary, with a phone call. And the Presto service does this very well.

It will be interesting to see whether we baby boomers, who now spend much of our lives around computers and cell phones, will find ourselves baffled by whatever is the latest in technology when we reach our 70s and 80s. Righ now, however, clearly a lot of people have been left behind personal technology, and these well-designed efforts to he them catch up a bit are most welcome. ■

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MediaCentric

BY JON FINE

The Google/YouTube Come-On

Google and YouTube are dangling nine-figure sums in front of major programming and network players—that is, the Time Warners, News Corps, and NBC Universals of the world. Google calls these monies licensing fees, according to executives who've been involved in the discussions. But some of them characterize the subtext like this: Don't sue us over copyrights. Take this (substantial) payment, and trust us to figure out how we'll all make serious money once we get advertising and revenue sharing worked out.

The offer, and YouTube's rapid rise, force the titans of a time past to make a very big decision quickly. If you're a network, you can't ignore YouTube's reach. (Some 23.5 million unique visitors went there in October.) But if you're a network, you also believe you can't give up your stuff lightly. Your copyrights, and insisting on your programming's premium value, underpin the entire business model.

TO COMPLICATE MATTERS, no publicly traded media company today is in a position simply to dismiss, say, $100 million. Such a sum far exceeds what any single broadcast network can extract from the online world—and drops straight to the bottom line. But taking the dough fortifies an already threatening rival. One executive privy to the discussions says: "The reality is, if they are able to lock in major media [companies] for three years, then by default YouTube is the place to go" for Web video. Such fears may be what's spurred several major media players to mull assembling a cross-company Web video destination—a YouTube killer of their very own.

STEWART, *IDOL*, SIMPSON Today contraband on YouTube, tomorrow...?

"The theory is that if you were to aggregate enough exclusive content in one place, you could actually change viewing patterns," says an executive familiar with the cross-company talks. Perhaps anticipating my jumping all over the fallacy of "exclusive" in an open online ecosystem, he concedes "it's really tough," though not impossible.

I will not try to convince anyone that the choices media companies face are easy, but believing that 5 or 10 of them can grind through nightmarish cross-corporate decision-making and emerge with something as simple and compelling as YouTube is nuts. I don't necessarily buy the notion that only outsiders concoct interesting next-generation plays like Google, YouTube, Friendster, and iTunes. But I do know that if I can't spend a half-hour watching live Sex Pistols clips from 1977 on a NewTube—as I just did on YouTube—my interest in it falls off a cliff. (While many existing Web video outfits from Break.com to Microsoft and Yahoo!, would likely delight in hosting a YouTube rival, bringing them on means another party at the table.)

Still, take a moment to appreciate the multiple ironies. You could argue that *Saturday Night Live*'s goofy, pretty much perfect mock rap video *Lazy Sunday* made YouTube ultrahot last December. You also could argue that the kindling was in place, and only timing meant *Lazy Sunday* struck the spark and not, say, Lonelygirl15. Or, for that matter, that NBC got promotional bang out of *Lazy Sunday*'s multimillion views far outweighing old-school copyright concerns. (It was the first time I'd seen *SNL* in years, and the first time I laughed at it in about 20.) Thus, the YouTube version of the chicken-egg conundrum: Which party needs the other more? One executive's prediction that some licensing deals will get done indicates where the power now lies.

Media execs familiar with the YouTube offer won't discuss it publicly. Neither will Google. But it's interesting that no programming giant has sued YouTube yet. Presumably those guys won't unleash the lawyers until certain talks are played out. Or maybe—indulge me in some crazy dreaming—they know that they can't sue their way out of this.

BusinessWeek.com For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia.

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JAMES C. COOPER

Why Capital Spending Should Pick Up Again

e economy's unsung hero is slowing—but maybe not for long

U.S. ECONOMY Corporate America has been one of the unsung roes of the economy's resilience this year. Even during a year of bal unrest and great uncertainty over oil prices and housing, mpanies have continued to plow billions of dollars into new tories, offices, equipment, and software in an effort to expand ations and take advantage of growth opportunities me and abroad. Those investments have generated jobs and income, and they have played a big role in tting the drag from the housing recession.

at's why recent signs of slipping business dence will require close attention in coming ths. Over the past few months, surveys by the ness Roundtable, the Conference Board, and the nal Federation of Independent Business, which sents small concerns, all indicated less confidence e future, and all showed some scaling back of capital ding plans.

rhaps the best gauge of business confidence is the me of orders companies are placing for capital goods. e represent a company's financial commitment to re growth, and the latest news is not encouraging. ufacturers saw a sharp drop in their incoming orders apital equipment in October, and shipments declined e second month in a row (chart). That pattern ests capital spending may provide less of a buffer st the housing slump than many economists had cted, especially in the fourth quarter.

IMPORTANT QUESTION for 2007: Is this latest d of corporate skittishness just a temporary lull mething fundamental that could further depress all economic growth? For now, it looks as if any ack by business will be short-lived, so long as veakness in the economy is confined to housing truction and auto production. Those two areas tend ing sharply over short periods, and they can weigh ily on the industrial sector, as they are doing now. ose two drags were clear from the latest report on -quarter gross domestic product. The Bureau of omic Analysis (BEA) bumped up its initial estimate wth for the quarter, from 1.6% to 2.2%, but of the upward revision reflected faster growth in tories. Business inventories have grown somewhat rapidly than many companies would prefer, and g those stockpiles down to size is likely to weigh on omic growth in the fourth quarter.

particular, auto production earlier this year ran far ahead of sales, forcing the current production cutbacks by Detroit. Also, as demand for construction-related materials and products has fallen off, those producers have had to make adjustments as well.

Those realignments, however, are already well under way. Automakers have cut output sharply, and Detroit is likely to offer another yearend round of sales incentives, as it has done for the past two years. Plus, home demand continues to show signs of stabilizing. Sales of new homes dipped in October, but they had risen in both August and September, and October sales of existing homes increased. As housing demand firms up, declines in residential construction will become less of a drag.

Another temporary factor may also be at work. The big 5.1% drop in October orders for capital goods, other than those for aircraft or from the military, reflected an unusually steep 10.2% decline in demand for computers and electronic products. But the speculation is that businesses may be holding off buying new hardware until Microsoft Corp.'s new Vista operating system is rolled out in late November.

SIGNS OF WEAKNESS IN CAPITAL SPENDING

Data: U.S. Census Bureau, Global Insight Inc.

The lift to economic growth from business investment in the coming year may not match the 8%-9% growth rate expected for all of 2006. But barring some new shock to business confidence, most economists still expect corporate outlays to grow next year, once again much faster than overall GDP.

THE STRONGEST REASON to remain optimistic about capital spending in the coming year is the solid set of economic fundamentals underlying it. Many of the same forces that spurred business investment this year will also be at work next year: Spending by U.S. consumers and foreigners is expected to lift demand, and production

capacity should remain tight, as factory operating rates stay high and unemployment remains low. Plus, businesses are still catching up with demand after the huge cutbacks in spending on new plants and equipment following the investment bust earlier in the decade.

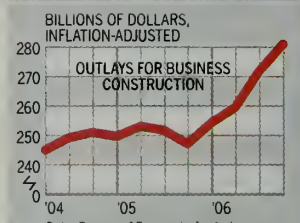
That point is supported by the boom in business construction. Outlays for new factories, warehouses, and other commercial space through the third quarter have soared 14.4% over the past year, the fastest yearly advance in two decades (chart). It's a sign businesses are not just investing in new productivity-enhancing equipment. They are expanding their operations, and that new space will require more equipment and workers.

FINANCING ISN'T LIKELY to be a problem. Profits are set to keep growing, although at a slower pace than this year's high double-digit rate. The government's roundup of company earnings, released along with the updated GDP numbers, shows continued strength in profits. Because the BEA's data account for normal seasonal variation, earnings can be compared from quarter to quarter. Profits increased a solid 4.2% from the second quarter, and they were up 30.9% from a year ago, a surge mainly reflecting last year's hurricane-related weakness.

Profits typically grow more slowly as a business cycle ages: Productivity gains begin to diminish, the way they are doing now, as businesses depend on fatter payrolls to expand production. That means labor costs rise faster, as is also happening now, and profit margins tend to get squeezed. Still, earnings next year get support from a growing economy, a little more pricing power, and a weaker dollar, which will boost earnings from abroad, when they are translated back into U.S. currency.

Also, even as internally generated funds slow, capital markets still offer low-cost financing opportunities, and banks are aggressively looking for new business. Up to this point, the corporate sector has tapped a gusher of cash flow nearly sufficient to cover the sector's bill for capital outlays. That's highly unusual by historical standards.

WHERE BUILDING IS BOOMING



Data: Bureau of Economic Analysis, Global Insight Inc.

The result is that many companies have not had to add greatly to their debt in order to finance their expansion. Corporate balance sheets are very strong. The ratio of liquid assets to liabilities is exceptionally high, and their ratio of debt to net worth is unusually low. All this puts companies in an excellent position to borrow at a time when interest rates are still low and the rising trend in stock prices is a boost for equity financing.

The chief risk to the capital spending outlook is the housing recession. If the housing slump begins to spill over into other sectors, especially consumer spending, then businesses will sound a retreat. So far that's not happening, but the October falloff in capital goods orders and shipment bears watching. ■

EMPLOYMENT

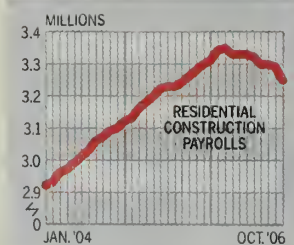
Harder Times for Hard Hats?

THE WIDELY predicted decline in construction employment caused by the housing slump may finally be getting under way. But the upcoming November job report, due on Dec. 8, and subsequent figures this winter may still not fully reflect the pullback. That may not occur until the spring.

In October, as the inventory of new housing remained high and housing starts plunged, construction payrolls fell by 26,000 workers. That was the biggest monthly drop since February, 2003, and it held the gain in overall hiring to just 92,000 workers, the smallest in a year.

Even with the October drop, construction payrolls are still up by 144,000 from a year ago. That's because hiring in the nonresidential sector, where activity is booming, has been brisk. Outlays in this sector are about half those in housing construction, but the nonresidential area employs more workers.

PLENTY MORE JOBS TO CUT



Data: Labor Dept., Global Insight Inc.

What's more, the job decline in home building so far has been small—only 93,000 since the February peak. But the lag between housing starts and completions is 6 to 12 months, according to Goldman Sachs chief U.S. economist Jan Hatzius. Builders didn't start scaling back starts until early this year, so the need for workers is only now diminishing.

This drop in activity comes as winter approaches just when builders normally lay off seasonal workers. Therefore, Labor Dept. data, which are seasonally adjusted to account for the pattern in construction hiring, may not show the full impact. Concrete signs that housing's plunge has hit payrolls may not surface until next spring, when builders traditionally ramp up hiring.

If builders keep payrolls lean, the seasonally adjusted numbers for construction payrolls could show big drops, since actual hiring would be much less than the expected seasonal pattern. Indeed, Hatzius believes residential payrolls could end up falling by 600,000 workers in the next year or two if housing activity only holds where it is now. Even if nonresidential construction remains hot, it would not be able to offset or offset a drop of that magnitude. ■

–By James Mehring in New

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Xmas Gloom? 'Tis a season retailers might not find so jolly. Despite massive discounting and earlier-than-ever openings, the Thanksgiving weekend kickoff to the holiday spending spree proved soft. **Wal-Mart** clouded **Black Friday** (so called because it's when retailers traditionally move into the black), announcing that it expected its worst November sales in over a decade. JPMorgan Chase retail analyst Charles Grom says that while industry sales momentum started strong on Friday, "it seemed to lack follow-through." Indeed, sales for the week fell 0.4% from the previous week, reports the International Council of Shopping Centers.

There were bright spots: Low-priced chains **Kohl's, Target,** and **J.C. Penney** did well (a California Target store, photo), as did high-end retailer **Coach.** And more holiday shoppers spent online: Sales on the Monday after T-day, dubbed **Cyber Monday,** rose 26%, according to comScore Networks. But discounts look like the big motivator. "In 20 years doing consumer research on Christmas sales, I've never seen such bargain-driven shoppers," says America's Research Group's Britt Beemer. That won't help retail profits.

ONLINE *See "O, come all ye online shoppers," www.businessweek.com/go/tbw*

Reading the Economy Yes, the government raised its estimate of third-quarter growth on Nov. 29. No, that doesn't mean the economy is in the pink. The **Commerce Dept.** said output increased at an annual rate of 2.2% in the quarter, up from a previous estimate of 1.6%. Trouble is, a lot of the improvement came from inventory accumulation—meaning unsold goods piling up on shelves. On Nov. 28 economic softness pushed the dollar to a 20-month low against the euro. Nonetheless, **Fed Chairman Ben Bernar** continued to fret in a Nov. 28 speech that the core inflati rate is "uncomfortably high."

See "Excuse me, Mr. Chairman...," page

Brother, Can You Spare $18 Billion? **Ford** is lit ally betting the house on its restructuring. The banged- carmaker said on Nov. 27 that it wants to raise $18 billi in cash by borrowing against assets that include its he quarters building, plants, tooling, and even intellect property. Ford needs the cash: It says some 38,000 empl ees, almost half the U.S. factory workforce, have accep buyout offers. That will help drain $17 billion from 2(through 2009, leaving a cushion of about $20 billion.

Options Scandal Watch The casualty list grows lon still. On Nov. 26, **Affiliated Computer Services CEO Mark** stepped down, along with his CFO. And on Nov. 22, **Mon Worldwide** fired its general counsel in the wake of a st options probe that cost its founder and chairman, **And McKelvey,** his job in October.

ONLINE *See "How to clean up a scand www.businessweek.com/go/*

Exchange Mates Finally. On Nov. 28 the nation's lar securities regulators said they would team up, possibl soon as mid-2007. Talk of a courtship between the **New Stock Exchange** and the **National Association of Securities Dea** has been buzzing for years, but only in recent months the stars align. **Richard Ketchum,** the NYSE's chief regula officer, and **Mary Schapiro,** chairman and CEO of the N were able to seal the deal. Schapiro will lead the new o nization, which will oversee member regulation, exam tions, arbitration, and mediation. The news sparked zahs on Wall Street, which has griped about overlap and sometimes conflicting oversight.

From Bentonville to Bangalore For years, **Wal-** has been knocking at India's door. Now it may have fo a way in. On Nov. 27 the world's biggest retailer annou a deal with India's top telecom company, **Bharti Enterp** that gets around government rules on foreign retail in ment. Wal-Mart and Bharti will float a joint venture t up supply-chain and warehousing facilities, while B will run an as-yet-unnamed chain of hypermarkets, su markets, and neighborhood stores.

Airline M&A Mania Bids for carriers are getting borne all over. U.S. private-equity outfit **Texas Pacific** is teaming with Australia's **Macquarie Bank** in an offe **Qantas** worth nearly $8 billion, while **Air France** and **KL** mulling an acquisition of sputtering **Alitalia.** News of deals surfaced within days after **US Airways** announ bid for **Delta** on Nov. 15. The overseas tieups face obst though. Shares in recently merged Air France-KLM bled 12% on news of the possible Alitalia move. W Qantas sale seems more likely to go through, the Austr

vernment promises to block any deal allowing more than % of the carrier to fall into foreign hands.

LINE *See "Texas Pacific, Macquarie queue up for Qantas," www.businessweek.com/go/tbw*

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izer Slims Down When Pfizer's board tossed out **CEO nry "Hank" McKinnell Jr.** in July, it was clear the world's gest drugmaker intended to clean house. On Nov. 28 w **CEO Jeffrey Kindler** took his first big swipe, stripping out % of Pfizer's sales force, some 2,200 reps. Pfizer has been uggling to release new drugs to replace aging hits such cholesterol-lowering **Lipitor** and antidepressant **Zoloft.**

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inkiller Relief Also on the pharma front, **Merck** won ig one in the legal tussle over **Vioxx,** its withdrawn pain-ler. On Nov. 22 a federal judge in New Orleans refused lump the 20,000-plus lawsuits filed against Merck by mer Vioxx users into a class action. Merck has said all ng it would try each case rather than agree to a group tlement that could run into the billions. The company s won 7 of the 11 Vioxx suits that have gone to trial, al-ugh a judge ordered one victory to be retried.

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uld Nestlé Gobble Gerber? The Swiss food giant has g coveted the baby-food maker and now is looking to buy it m Swiss pharma **Novartis,** *The Wall Street Journal* reported Nov. 29. Along with a medical nutrition unit, Gerber might ch around $5 billion. Novartis is eager to get Gerber off its te to concentrate on the drug biz. Nestlé isn't comment-, but analysts say Gerber would make a nice addition. It minates the U.S. baby-food market, and those mushy peas d carrots produce some mighty tasty margins.

Exit of the Week

nn Fudge predicted it would take three to five years to rn around **Young & Rubicam Brands** when she took over s chairman and CEO in 2003. Now, with mixed results t the helm, she's moving on. Fudge, 55, said on Nov. 28 at she will retire at yearend to focus on nonprofit work rough such groups as the **Rockefeller Foundation** and the **ouncil on Foreign Relations.** The former **raft Foods** marketing star had to cope ith an industry downturn and an ften frosty working environment at e advertising conglomerate—fend-g off criticism about her lack of ad xperience, as well as her decision to ke two years off after quitting Kraft 2001. She also seemed to focus ore on internal initiatives than on stering memorable creative work. Last year, amid cli-nt defections, she lost the job of heading the flagship &R agency. With the appointment of **Hamish McLennan** arlier this year to run it, Fudge's days were numbered.

ANN FUDGE

ONLINE *See "Y&R's Fudge heads for the exit," www.businessweek.com/go/tbw*

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SHARP TURNS

WAGONER'S FIGHTING CHANCE

GM's CEO has slashed $9 billion in costs and eked out a profit. That buys him time to cut billions more

BY DAVID WELCH

MAYBE IT'S TIME to give G. Richard Wagoner Jr. his due. Just a few months ago, the beleaguered chairman and CEO of General Motors Corp. was battling a direct assault from shareholder Kirk Kerkorian and fending off speculation that his company was headed for inevitable bankruptcy. Now, Wagoner has won the first couple of rounds against Kerkorian, who isn't going away but has abandoned efforts to unite GM with Renault-Nissan and reduced his stake in the company. And on the strength of improved financials, the bankruptcy chatter has become almost inaudible.

For better or worse, GM is in Wagoner's hands right now. He'll be the person masterminding the next stage of the company's rescue plan—not Renault-Nissan CEO Carlos Ghosn, Kerkorian adviser Jerome B. York, or any other outside savant with strong opinions about GM's problems. Wagoner has already taken a big first step, cutting $9 billion in costs. But in an interview with *BusinessWeek* he revealed that he is going to have to make cuts of that magnitude again over the next few years. "I don't think you can say the business is fixed, particularly in North America," said Wagoner in an interview in his office overlooking the Detroit River. "We have a lot more work to do."

Wagoner acknowledges that the first-round of cost reductions was a lot easier than the next one is going to be. He will be seeking savings primarily in two places: from labor concessions and a long-overdue makeover of the company's byzantine automobile design process. Next July, GM negotiators will sit down with representatives from the United Auto Workers to hammer out a new four-year deal that will be one of the most important labor pacts in the company's history. GM will be targeting health-care costs and the controversial JOBS bank, a program that pays laid-off workers nearly their full wages.

Just as important, Vice-Chairman Robert A. Lutz is going to simplify the way GM designs cars. Each region of the world, for the first time, will take responsibility for the engineering of particular models for the global market. The U.S., for instance, will focus on sports cars, SUVs, and pickups. Europe will handle midsize cars. The

STEPHANIE M. DIANI

"I don't think you can say the business is fixed, particularly in North America. We have a lot more work to do."

–Rick Wagoner
CEO, GM

hope is to end years of redundant engineering and save the company billions.

These initiatives are critical because, despite the recent improvement in performance, GM is still just treading water. It's reporting a profit of about $1.9 billion through the third quarter of 2006, after taking into account about $5.7 billion in restructuring charges and other one-time costs. But that was padded by about $900 million from asset sales, tax windfalls, and other one-off boosts. Wagoner & Co. "have been very aggressive in selling their accomplishments," says John Casesa of auto industry analyst Casesa Shapiro Group. "But that contrasts with very weak financial performance."

WALKING THE TIGHTROPE

WHAT WAGONER has achieved so far is not a turnaround. Think of it as a reprieve. Vice-Chairman and CFO Frederick A. Henderson says this year's restructuring has gotten GM only "a little more than halfway" toward Wagoner's stated target of dropping structural costs from 34% of revenue to 25%. If Wagoner hits that target, the company would still have higher expenses than Japan's top carmakers. But GM would be profitable, says Sean McAlinden, chief economist at the Center for Automotive Research (CAR) in Ann Arbor, Mich., and a frequent company critic. He forecasts that the company will be viable, but that it will inevitably surrender the title of world's No.1 car manufacturer to Toyota. "They have a pretty good plan," McAlinden says. "But they have to keep shrinking."

Retrenchment will be high on Wagoner's agenda next year when GM commences negotiations with the UAW. His representatives plan to go after some long-standing union benefits that workers in other industries, like steel and airlines, were forced to give up years ago. Given Detroit's struggles, the union will have to make concessions. But don't expect GM to make 70 years of lavish giveaways suddenly vanish. Wagoner will have to walk the tightrope of cutting labor and retiree costs as far as he can while still leaving UAW President Ron Gettelfinger with a deal he can sell to his members.

Consider the issue of bloated healthcare costs, often held up as an emblem of GM's dysfunction. On average, active union hands in industries across the U.S. pay about $3,000 a year toward medical coverage, says CAR's McAlinden. Retirees pay even more. If the 83,000 active GM union workers, who now fork over only a nominal co-payment for their coverage, shelled out what the average U.S. union worker pays, GM could save $250 million a year. If the 450,000 retirees paid that much, GM would save a further $1 billion.

CADILLAC PLANT Crucial union negotiations are set for next year

Sounds like a reasonable goal for company just off deathwatch, but do bet on such drastic changes. Since t UAW agreed to cut 35,000 GM jobs a a dozen plants, some members feel th have given enough. And that's not t only obstacle. In a hard-won concessio the UAW also agreed that retirees wou pay up to $750 a year for health care. A terwards, some union retirees sued, clai ing that their benefits were guarante The courts disagreed—but froze reti benefits at the current level until 20 It's possible to modify this deal, but o with judicial consent. "I don't think t problem with health care was created o the past two years," says Wagoner. "

MARKETING

'Just as Good as Toyota' Is a Tough Sell

Deep inside General Motors Corp. headquarters in Detroit, the marketing team studies a chart that tells them which brands of consumer products car shoppers equate with GM nameplates. Saturn does well, clustered near Panera Bread, a hot brand that evokes comfort and quality. On the other hand, Chevy, Buick, and Pontiac, three of GM's best-sellers, "are way too close to Burger King," says Paul Ballew, executive director for global market and industry analysis at GM.

Gaining consumers' respect is one of GM's biggest challenges. It can restructure the company. It can cut a new deal with labor. But if it can't convince people that it makes quality vehicles, the other initiatives won't pay off. Internal GM surveys indicate that consumers

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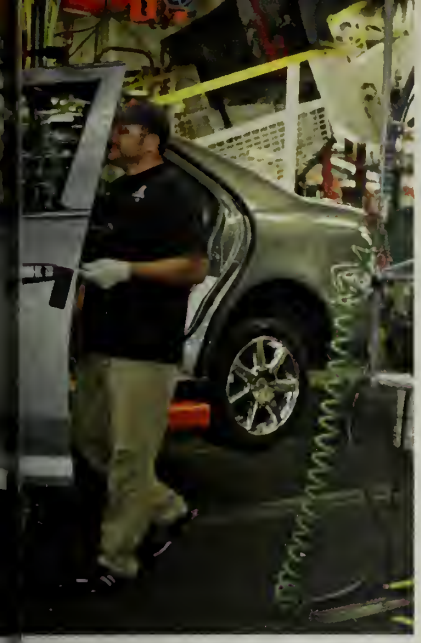
(TOP) BILL PUGLIANO/GETTY IMAGES



n't expect it to be fixed over two years." Look for Wagoner to try alternative ategies to cut costs. One idea: funneling company's retirees into a smaller num- of health-care plans without changing ir individual contributions, saving mil- s on larger volume rates from the rance carriers. Similarly, the company probably try to cut the cost of the JOBS k without killing GM and the other omakers could otiate a deal that es half wages in- d of nearly full . They could also mandatory cost-

of-living increases, which cost GM nearly $300 million this year.

The changes that GM is making to the way it designs cars won't get as much attention as the labor talks, but they may be more profound over time. For too long, Wagoner says, GM has made several models that chase similar buyers. While Toyota Motor Corp. goes to market the world over with one Camry, GM has a handful of rival sedans built with different parts in widely scattered factories. Says Lutz: "We're just doing what Honda and Toyota have been doing."

One implication of this new setup is that different regions will design different vehicles. Brazil will develop small trucks, GM's Daewoo in South Korea will engineer subcompacts, while Australians will take the lead in rear-drive cars. The vehicles will be styled and branded differently, but most of the insides will be identical.

This move reflects Wagoner's recognition that some of GM's best minds work overseas. In Europe, he notes, passenger cars are the heart of the market. In contrast, American engineers regard them as econoboxes. "It gets to societal issues," he says. "Europe had a [high] gas tax before it was an issue in the U.S. Our best ability to do small and midsize cars is in Europe and Asia."

The makeover also stems from GM's need to fashion more new models with less cash. Even though Wagoner has upped product spending, he gets outspent by many rivals. GM's capital expenditures and research and development spending equal 9.2% of its revenue, according to Merrill Lynch & Co. Toyota spends 12.1% of its revenue on new cars, plants, and R&D, Nissan spends almost 11%, and Honda Motor Co. 10%. GM's passenger car business may be the best example of how the company plans to get more from less. Take Saturn. The brand was starved of new cars for years. But by 2009 it will have three cars from Opel, which it will rebadge as Saturns.

Sharing models in this way can save billions. Wagoner says that bringing overseas models to the U.S. slashes 50% to 75% of the development costs of a new model. Since each new vehicle costs about $500 million, GM can cut up to $1 billion out of its Saturn budget and give the brand a full line to sell. "It's very powerful," boasts Wagoner. He is, of course, in no position to declare victory. GM is burning cash, the union won't cave easily, and with Kerkorian still in the background, Wagoner's plan must deliver results. Or he may find his new lease on life short-lived. ■

BusinessWeek.com For a review and slide show of the new Saturn Outlook, and a story about the turnaround at GM's European division, go to businessweek.com/extras.

Trust Issues

GM's quality nearly equals Toyota's. Yet public trust in GM brands lags far behind what most of its rivals enjoy.

PERCENTAGE ASSOCIATING "TRUST" WITH BRAND	
VOLVO	61%
TOYOTA	43
HONDA	35
CADILLAC	34
BUICK	23
SAAB	22
PONTIAC	22
CHEVROLET	21
GMC	20
HUMMER	16
SATURN	7

GM brands are in red
Data: Strategic Vision Inc.

M's vehicles are uel efficient than Motor Corp.'s, yet 23 models that get miles per gallon—an Toyota or Honda o. offer. And while er & Associates ality rankings dillac, Chevy, and arly on a par with nd Honda, those s haven't translated into public trust. quality is so close, but reputation for s another issue,"says Jeff Zupancik, J.D. director for retail research.

making its most concerted effort lose what sales and marketing chief LaNeve calls "the opinion gap." It ew ad agency, Deutsch LA, in the GM's most hostile territory, southern ia, to produce ads around its 100,000- ranty for new cars, quality gains, and economy of its models. It also wants to figure out how GM might use Buick spokesman Tiger Woods to promote GM as a whole. Most important, GM is committed to building a more consistent image. Buick has had five ad campaigns since 2000, and Pontiac and Saturn have had four apiece.

To get a better read on consumers , GM is changing how it does research. It's targeting a segment many automakers ignore: the "total avoiders." A J.D. Power study concluded that 25% of buyers don't consider GM brands because of reliability concerns; for Toyota, that segment is just 4%. Ballew says the group avoiding GM is too big—and full of younger buyers. "We have to find a way to break through that barrier," he says, or suffer as older Buick, Cadillac, and Chevy buyers die off.

Deutsch and GM are relying more on one-on-one customer interviews to point the way. That's how GM learned that customers feel the new warranty is worth about $2,300—good news since GM is cutting rebates. But other interviews, like one with a young pickup buyer, highlight GM's challenge—he bought a Chevy truck purely because of the discounts. The brand meant nothing to him.

Eric Hirshberg, Deutsch's co-president and creative director, says the agency is crafting a "confident" image and discarding ads that seem defensive. The warranty ads aim to evoke a feeling of freedom and power by showing GM cars escaping traffic by flying over other cars. Agency co-president Mike Sheldon said they adopted a trick that's guiding the work: "We pretended it was Apple Computer."

GM is now launching a series of crossover SUVs that it has reason to be confident about. The Saturn Outlook, for one, has been widely praised by the auto press, and its fuel rating beats the Honda Pilot. "But if a consumer shops the two together now," says LaNeve, "We lose on brand image."

–By David Kiley

MEDIA

WHY THE *TIMES* COULD GO PRIVATE

An LBO would be a long shot, but Sulzberger and an adviser are talking it over

BY TOM LOWRY AND JON FINE

EVEN BEFORE RESTIVE shareholders began ramping up pressure on the New York Times Co. and insurance mogul Maurice R. "Hank" Greenberg started buying shares, Chairman Arthur O. Sulzberger Jr. was thinking about taking the company private. In recent months, he has been quietly soliciting advice from trusted friend and financial adviser Steven Rattner, according to sources familiar with those discussions.

Rattner today runs Quadrangle Group, an investment firm he cofounded in 2000. But he and Sulzberger have been friends since the early 1980s, when both men were reporters in the *Times'* Washington bureau. Rattner's firm, which is active in private-equity deals, has been advising the *Times* for years. Last spring, *BusinessWeek* has learned, Rattner met with members of the Ochs-Sulzberger family, who control the voting shares of the parent company through a trust and hold 9 of the company's 13 director seats. He offered various strategic alternatives, say sources, including a leveraged buyout, for the company, which has a market cap of $3.3 billion, less than half its peak in 2002. Rattner and Sulzberger, who work out together in the mornings, continue to talk informally about the possibility of the *Times'* going private, say these same people.

Despite those talks, Sulzberger continues to defend, at least publicly, the current structure of the company, which has two classes of stock. The sources say Sulzberger never asked for a more formal private buyout plan from his old friend. Sulzberger declined to comment.

A buyout would offer all the usual enticements: a premium that some investment bankers estimate could be as much as 20% for shareholders, plus the opportunity to retreat from market scrutiny. But make no mistake: Going private soon remains unlikely and would be no easy feat. Even though speculation about Greenberg's intentions provides good theater, any buyout would require approval from six of the eight trustees who control the bulk of the Class B voting shares. And family members are not interested in giving up their regular dividend or the benefits of liquidity that a publicly traded company offers, sources say.

FRIENDS Rattner (above) met with Sulzberger and the family last spring

The dual stock structure has ensured family control and enabled the investment that allows the Times Co. to continue publishing what is widely regarded as the world's most influential media property. Given this family control and its presumed mission of protecting the *Times*, it's relatively easy to imagine the Ochs-Sulzberger clan playing a game of shareholder rope-a-dope: buying time perhaps, in the hopes the activists will find more pliant targets or the business climate will improve enough to boost the stock price. (Consider the fact that Carl C Icahn is much less interested in breaking up Time Warner Inc. now that the media giant's stock tops 20.) Such control has insulated the Times Co. from the same kind of market pressures that tore apart newspaper company Knight-Ridder In last year and is now forcing Tribune C to explore various sale scenarios.

WEB THREAT

STILL, THE *TIMES* FACES increasing withering scrutiny. Investors holding more than a quarter of its common shares withheld votes for directors the annual meeting in April. At the same time, Morgan Stanley Investment Management, which owns 7.6 of the company's common shares, filed documents with the Securities & Exchange Commission r questing that the dual sha structure, never popular wi governance hawks, put to a shareholder vo The firm also wants t position of chairman a publisher, held by Su berger, to be separate The Times Co. is esp cially vulnerable becau its big-city newspape are facing major threa from the Web. Sin January, the publishe shares are down 14%, about 24.50. On Nov. Citigroup analyst W liam Bird downgrad the stock to "sell."

The Times Co. is a unique juncture in long and storied histo but the ownership si ation looks likely to rule out immin action. One private-equity executive all people, points out that shareho ers bought into the *Times*, which been public since 1967, fully aware its dual stock structure. And that have squawked about a similar setu Berkshire Hathaway Inc. ■

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MORTGAGES

A FAREWELL TO ARMs? NOT QUITE YET

New classes of lenders are jumping in to offer high-risk mortgages

BY MARA DER HOVANESIAN

ONE OF THE UGLIEST consequences of the last housing boom has been the rise of risky loans known as option ARMs. The adjustable-rate mortgages let borrowers make smaller monthly payments than they actually owe, with the shortfall getting tacked onto the balance. In recent years that feature has allowed many people to buy more house than they could otherwise afford. Once the balance hits a certain level, the loan resets with higher payments—often, so high that borrowers end up in deep financial trouble.

Bank regulators have been paying close attention. In October, the Office of the Comptroller of the Currency issued new underwriting and disclosure rules designed to protect consumers from risky loans they don't understand. These new standards, along with the weakening housing market, have had a chilling effect on some big option ARM lenders: Washington Mutual Inc.'s volume fell 29% in the third quarter from a year earlier, to $11.6 billion, while Countrywide Financial Corp.'s originations dropped 48%, to $14.9 billion.

But that doesn't mean option ARMs are going away. According to Desmond Macauley, a managing director of RBS Greenwich Capital, a brokerage and research shop, option ARMs made up 15% of mortgage originations in the first half of this year, up from 8% last year. And much to regulators' chagrin, most of that volume has come from new players that don't fall under the purview of the OCC: investment banks, real estate investment trusts (REITs), private equity players, and other mortgage outfits eager to make option ARM loans and then sell them off to professional investors.

Mortgage REITs have been feasting on exotic mortgages lately. American Home Mortgage Investment Corp., for instance, originated about $5.4 billion of option ARMs in the third quarter of 2006, making it the No. 7 option ARM lender behind Countrywide, Golden West, and Washington Mutual. Analyst David C. Stumpf A.G. Edwards Inc. in St. Louis notes th American Home's underwriting standar seem solid so far. But he worries that i independent sales force of brokers may n be explaining the risks well enough to th customers. "There is no question that t risk profile is elevated," he says. Americ Home Mortgage declined to comment.

ENTER WALL STREET

GENERAL MOTORS CORP.'S mortga financing business has also been a hu player in option ARM lending lately. Homecomings Financial unit alone i creased its volume to $1.6 billion in t third quarter, up from $769 million l year. GMAC is set to be sold to New Yo private equity firm Cerberus Capital Ma agement and other investors, where it w stay outside the OCC's reach. GMAC say makes sure consumers know the risks a that it lends only to strong borrowers.

Wall Street is getting into the gar too, by acquiring mortgage lende Merrill Lynch on Sept. 5 bought Fi Franklin Financial from Clevela based National City. Morgan Stanley Aug. 9 agreed to buy subprime und writer Saxon Capital Inc. Others are the block, including H&R Block's Opt One unit. The Street's goal: to obt pipelines of mortgage loans they sell directly to investors.

For now, it's working. "There's a trem dous amount of cash in the marketpl searching for return," says Jim S. Fow director of research at JMP Securitie boutique investment bank in San Fr cisco. Adds Frederick Cannon, an eq analyst for New York-based Keefe, Br ette & Woods: "From a pure profitab standpoint, these loans still look pr good to these people." But, he says, interesting that the people who know product best are scaling back."

The biggest worry for consumer ac cates is the market's shift from regul to unregulated play Now it's up to indivi states to rein in op ARMs. Says OCC Ch man John C. Du "The issue is whe states will adopt nontraditional m gage guidance in same form as the eral agencies. If they will they implem in the same way? T could well be a sig cant gap." ■

The Wild Bunch

As Countrywide and Washington Mutual dial back on their exotic mortgages, players not covered by new banking regulations are stepping up

NAME	OWNERSHIP TYPE	LOANS (BILLIONS)	YEAR OVER YEAR CHANGE IN VOLUME**
GMAC MORTGAGE UNITS	Private Equity/Cerberus*	$18.6	485%
MORTGAGEIT	Investment Bank/Deutsche Bank	6.2	84
NOVASTAR FINANCIAL	Real Estate Investment Trust	2.4	1,263

*Purchase from General Motors Corp. is expected to close by yearend **Nine months through October
Data: Keefe, Bruyette & Woods, *National Mortgage News* (based on bank disclosures)

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200601

COMMENTARY

BY PETER COY

Excuse Me, Mr. Chairman...

What we would have asked Bernanke if we had the chance

BEN S. BERNANKE GAVE A speech on the economy on Nov. 28 in New York, but he exited via a side door afterward without taking questions. Last I saw them, the Federal Reserve chairman and his posse were piling into black cars and zooming down Fifth Avenue, blue lights flashing. Oh, well. If Bernanke had stayed around for questions, here are some of the things I wish I could have found out from the man with a grip on the nation's money spigot:

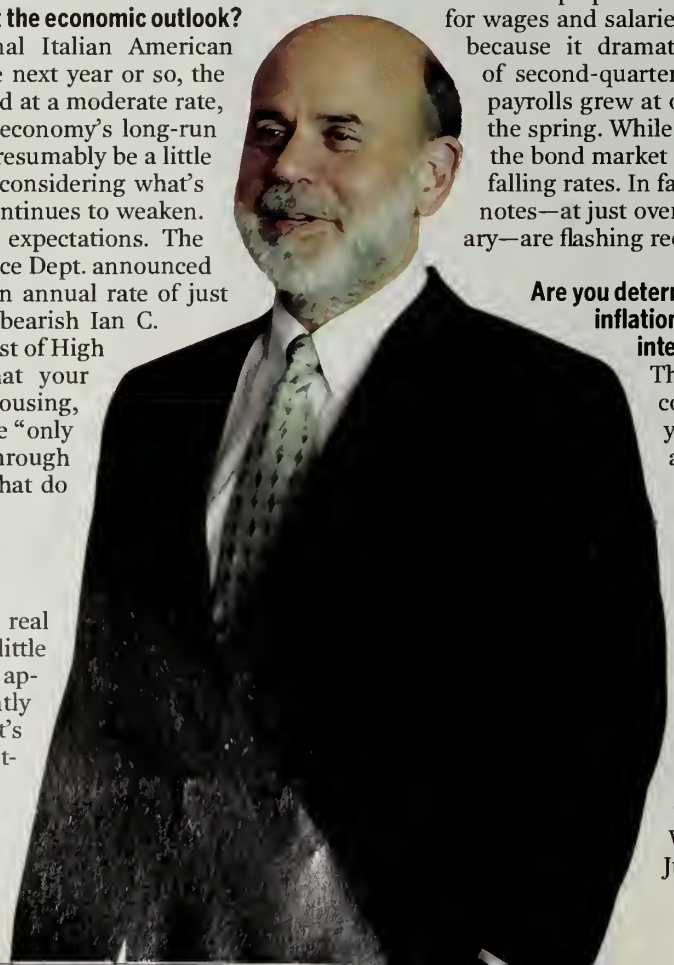
What makes you so cheerful about the economic outlook?
In your speech to the National Italian American Foundation, you said: "Over the next year or so, the economy appears likely to expand at a moderate rate, close to or modestly below the economy's long-run sustainable pace." That would presumably be a little under 3%, which is pretty good considering what's going on these days. Housing continues to weaken. Consumer confidence is below expectations. The day after you spoke, the Commerce Dept. announced that economic output grew at an annual rate of just 2.2% in the third quarter. The bearish Ian C. Shepherdson, chief U.S. economist of High Frequency Economics, said that your remarks on economic growth, housing, capital spending, and so forth are "only plausible if the data are viewed through deeply tinted rose lenses." So what do you see that others don't?

What house prices have you been looking at lately, Dr. Bernanke?
Here's what you said about the real estate market: "There can be little doubt that the rate of home-price appreciation has slowed significantly for the nation as a whole." That's an understatement. Prices are outright falling by several measures, though not all. Short before your speech, the National Association of Realto announced that the median sales price for existing hom in October was 3.5% lower than the median a year earlie That's not just a slowing of appreciation. It's true that th Realtors' numbers are skewed by a downscale shift in the m of homes sold. Still, that was the biggest annual decline sin the Realtors started collecting numbers in 1968.

Why are you so worried about inflation?
You said: "The level of the core inflation rate remains uncom fortably high," and you worried that labor costs "have bee rising more quickly of late." Sure, it's the job of the Feder Reserve to be extra vigilant on inflation, and we're glad you' on the case. But there's mounting evidence that you m be too gun-shy, especially about pay hikes. On Nov. 29 t Commerce Dept. put out an unexpectedly low estima for wages and salaries in the third quarter, large because it dramatically lowered the estima of second-quarter pay. As a result, corpora payrolls grew at only a 2.7% annual rate sin the spring. While you talk about high inflatio the bond market is expecting low inflation a falling rates. In fact, yields on 10-year Treasu notes—at just over 4.5%, the lowest since Jan ary—are flashing recession warnings.

Are you determined to squeeze down inflation by keeping short-term interest rates high?
There's a theory that the "u comfortably high" inflati you worry about won't away unless the econo stays sluggish long enou that the unemployment r rises. Is that what you lieve? Would that expl why you and the rest the Federal Open Mar Committee are keeping federal funds rate at 5.2 and even hinting that could possibly go higher

And finally, how was the food?
We reporters didn't get to Just asking. ■



LOOKING GOOD Bernanke sees healthy economic growth ahead

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WHERE A TEACHER CAN MAKE MILLIONS

Korean kids are jamming into "cram schools"—as parents pony up big-time

BY MOON IHLWAN

THE STAGE OF SEOUL'S biggest indoor arena is flanked by two giant video screens to ensure that even folks in the nosebleed seats won't miss a thing. As the performers take the stage, the crowd of 10,000 breaks into thunderous applause. But the stars of the Nov. 25 show aren't a pop band or a rap group. They're instructors from Megastudy, the biggest of Korea's 28,000 "cram schools" that help students get ahead in everything from physics to French. "With his signature, I feel his energy," 18-year-old Yang Hae Jin beams after scoring an autograph from one of the celebrity teachers.

Koreans will endure just about any hardship to make sure they get into a top university. A degree from a leading school isn't just the key to a good job—it's a prerequisite for finding the right spouse and establishing high-powered connections that can last a lifetime. That has fueled rapid growth in the cramming industry, which takes in some $15 billion annually. The best schools charge upwards of $1,000 a month per subject—a small fortune in a country where the average annual income is $16,000. "I spend about half of my income on after-school cramming for my kids, and I'm no exception," says Kim Hyon Chol, the father of two high school students, after attending the Megastudy event, an information session designed to give parents tips on college admissions—and woo new students.

Megastudy has built a booming business by tapping into the anxieties of parents such as Kim. The cram school company burst onto the scene in 2000, offering videotaped lectures online. Today its Web site lists 2,000 courses such as "Super-fast skimming of English grammar" and "200 classical poems in 10 days." Prices for lectures, which can be viewed on PCs or portable video players, range from $13 to $120.

That adds up fast. Megastudy's online sales will likely jump 40% this year, to $6[illegible] million. The company has in recent years added classroom instruction, boosting overall revenues to $107 million, with profits of $38 million, estimates brokerage Hyundai Securities. By 2010, revenue could reach $300 million, and despite stiffening competition for Megastudy, Hyundai expects it to clock margins of nearly 40% for several years to come. Investors have learned to love the stock as Megastudy shares have more than doubled this year. "E-learning represents a tiny portion of the education pie right now, but its rapid growth will soon push it to the mainstream," says Chief Executive Son Joo Eun, who founded Megastudy after 14 years as a cram school history teacher.

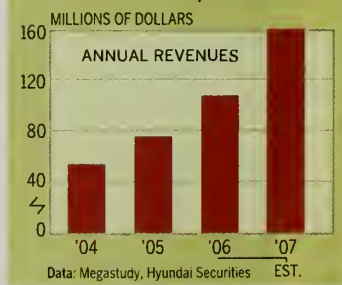
VARIED MENU

MEGASTUDY'S METEORIC RISE owes much to its popular lecturers. Son has signed up top talent by offering a 23% cut of online sales of videos—a deal that earned one English teacher $2 million last year. Korean high school students who spend as much as 18 hours a day studying, appreciate the flexibility that Megastudy offers. "Instead of sitting in a cram school for hours every day, I can choose the subjects I need to concentrate on," says Kim Jun Woo, 18, who is applying to prestigious Seoul National University. "And I can watch lectures by the best teachers, even though they're all based in Seoul," adds Kim, who lives 200 miles from the capital in the southeastern city of Gyeongju.

Megastudy's success in the virtual world has allowed it to dedicate more resources to real-world operations. The company has established up seven cram schools in Seoul and is even considering expanding to other Asian countries. "Online will soon be the main medium of learning," says Son, "but it will have to be complemented by face-to-face instruction."

VIRTUAL TUTOR

Annual revenues of Megastudy, South Korea's top online school



Data: Megastudy, Hyundai Securities

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ENERGY

SURPRISE: OIL WOES IN IRAN

Flagging output from its vast reserves could diminish Tehran's influence

BY STANLEY REED

FEW COUNTRIES CAN MATCH Iran in its ability to generate angst among Westerners. It appears determined to become a nuclear power. Tehran's Islamic leaders aid radical groups across the Middle East. And as the U.S. gets bogged down in Iraq, Iran's influence in the region is on the rise, fueled in large part by its vast energy wealth.

Yet Iran has a surprising weakness: Its oil and gas industry, the lifeblood of its economy, is showing serious signs of distress. As domestic energy consumption skyrockets, Iran is struggling to produce enough oil and gas for export. Unless Tehran overhauls its policies, its primary source of revenue and the basis of its geopolitical muscle could start to wane. Within a decade, says Saad Rahim, an analyst at Washington consultancy PFC Energy, "Iran's net crude exports could fall to zero."

That's not to say Iran doesn't have abundant resources. The country's 137 billion barrels of oil reserves are second only to Saudi Arabia's, and its supply of gas trails only Russia's, according to the *BP Statistical Review of World Energy*. Getting it all out of the ground, though, is another matter. Iran has been producing just 3.9 million barrels of oil a day this year, 5% below its OPEC quota, because of delays in new projects and a shortage of technical skills. By contrast, in 1974, five years before the Islamic Revolution, Iran pumped 6.1 million barrels daily.

The situation could get even tougher for the National Iranian Oil Co. (NIOC), which is responsible for all of Iran's output. Without substantial upgrades in facilities, production at Iran's core fields, several of which date from the 1920s, could go into a precipitous decline. In September, Oil Minister Kazem Vaziri-Hamaneh suggested that with no new investment, output from Iran's fields would fall by about 13% a year, roughly twice the rate that outside oil experts had expected. "NIOC is likely to find that even maintaining the status quo is a mounting challenge," says PFC Energy's Rahim.

STATE HANDOUTS

IRAN'S LOOMING CRISIS is the result of years of neglect and underinvestment. As in other oil-producing countries such as Venezuela and Mexico, the government treats the oil industry as a cash cow, milking its revenues for social programs. It allocates only $3 billion a year for investment, less than a third of what's needed to get production growing again.

Compounding the pressure are policies that encourage profligate energy use. Gasoline prices are set at 35¢ a gallon, which has helped fuel 10%-plus annual growth in consumption, PFC Energy figures. The national thirst for gasoline far outstrips domestic refining capacity, so Iran will import about $5 billion in gasoline this year, or about 40% of its needs. The government is planning a $16 billi refinery building progr to boost capacity by 60 But unless Iran raises f prices, the new plants v just mean more consumption.

TEHRAN TRAFFIC Low gasoline prices make for profligate domestic use

An oil squeeze could spell trouble President Mahmoud Ahmadinejad. T populist leader has won backing at ho through generous handouts. Ahmadi jad has ratcheted up public spend this year by 21%, to $213 billion, everything from aid to rural areas

Why Iran's Oil Output Is **Falling**

AGING FIELDS

Three-fifths of Iran's output comes from oil fields that are 50-plus years old. Production could fall by as much as 13% a year in many of these fields.

LOW INVESTMENT

Iran isn't spending enough to replace output. Sanctions keep Americans from investing, while tough terms and turmoil in the state-directed industry have scared off others.

OIL POLITICS

Companies linked to the Revolutionary Guards have gotten $8 billion in development deals, and China's Sinopec won a major field without competitive bidding.

RISING CONSUMPTION

With domestic gasoline costing just 35¢ per gallon, consumption is growing at 10% or more a year, forcing Tehran to spend $5 billion annually for imports.

Data: *BusinessWeek*

sing loans for newlyweds. He has promised some $16 billion in outlays n a special $30 billion fund set up to Iranians through future hard times. hout a healthy oil sector, Iran's social nding could bust the national bud—and reignite inflation.

ran badly needs fresh foreign investnt to shore up the oil industry. Tehhas attracted some $20 billion in ding for oil and gas projects since 5 from overseas companies includRoyal Dutch/Shell Group, France's Total, and Norway's Statoil. But new investment has largely dried up in recent years because of lingering worries about the risk of war with the U.S. and disenchantment with Iran's tightfisted terms. Outsiders are offered contracts only to drill wells—rather than operate fields—and get just a small share of profits from output. For instance, Italian oil giant ENI, a fixture in Iran since 1957, produces about 35,000 barrels per day but doesn't expect to get any bigger. "Unless international sanctions are imposed on Iran and the Italian government directs ENI to abide by them, we are committed to staying," says ENI Chief Executive Paolo Scaroni. "However, in order to increase our presence there, contractual terms for oil companies need to change."

Endless haggling and delays have set back some of Iran's biggest oil initiatives. One top priority had been the Azagedan field in southern Iran, which is expected eventually to produce 260,000 barrels a day. But in October, Tehran scrapped a $2 billion contract, agreed to in 2004, with Japan's Inpex to develop the project. And Shell's $800 million Soroush/Nowrooz project in the Persian Gulf has been plagued by cost overruns and technical glitches. In January, meanwhile, Statoil wrote down the entire $329 million book value of its South Pars project because of "productivity and quality problems" with a local contractor.

GLACIAL PACE

IT'S NOT JUST OIL that Iran is failing to exploit. The glacial pace of negotiations is also making it fall behind neighboring Qatar in exploiting the huge offshore gas field that the two countries share. While Qatar has signed up the likes of ExxonMobil and Shell to develop the site, Iran's talks with Total and Shell have progressed far more slowly. Iran is now a net importer of gas, a situation not expected to reverse before 2010.

Foreign energy companies are lobbying the Iranians to change. Executives say they would like longer contracts, which would give them more control and might boost returns. But progress is slow as many Iranian officials are reluctant to give foreigners terms that might be judged too favorable. "There are indications of movement, but how far and how deep it goes is anyone's guess," an oil executive says.

Can Iran fix its energy conundrum? Some experts are betting Tehran will get its act together sooner rather than later. Iran was able to boost production from 1.2 million barrels a day during the 1980-88 war with Iraq to nearly 4 million barrels with almost no foreign help, notes Bijan Khajepour, chairman of Tehran's Atieh Bahar Consulting, which advises oil companies. He thinks Iran should be able to sustain current production for the next decade. Even so, if Tehran doesn't face up to the woes of its oil industry, Iran may find itself in the unusual position of sharing the West's angst over growing dependence on imported oil. ■

–With Babak Pirouz in Tehran

INNOVATION/CASE STUDY

THINKING SIMPLE AT PHILIPS

A panel of outside experts is helping the electronics giant reinvent itself

BY KERRY CAPELL

TWO YEARS AGO, BRITISH fashion designer Sara Berman got an unexpected call from Andrea Ragnetti, the chief marketing officer for Royal Philips Electronics. Figuring the Dutch company wanted her to design some sort of wearable technology, she was prepared to politely decline the proposal. Instead, she spent an hour engaged in a freewheeling discussion on the meaning of simplicity, and by the end of the chat she had accepted Ragnetti's invitation to join Philips' Simplicity Advisory Board, a new panel of outside experts.

What does a fashion designer know about technology? Not much. But that's the point. To drive change following a radical restructuring, Philips reckoned it needed a fresh perspective from creative types with no ties to the company. So it formed the simplicity board, a group of specialists in health care, fashion, design, and architecture. "Philips was too inward-looking," Ragnetti says. "To really embed simplicity into the company's DNA, we needed an element of vision."

CHANGE AGENTS

THE FOUR-MEMBER board's mission: Help Philips focus on "sense and simplicity." That's what the company is calling a new branding initiative to underpin its transformation from a high-volume electronics maker into a design-led company concentrating on health, lifestyle, and technology. Berman—who heads a successful clothing label—is helping the company explore new opportunities in consumer products. Dr. Peggy J. Fritzsche, a radiology professor in California, advises Philips on its $8 billion medical-equipment business. Gary Chang, a leading architect in China, serves as a brand ambassador in the mainland. And John Maeda, a graphic designer and professor at Massachusetts Institute of Technology, is working to fine-tune the emotional appeal of the company's wares.

On a practical level, the board is helping Philips rethink what its customers want. For two years, members met for several days every month or two in cities such as Rome, Paris, or New York. Today they no longer meet as a group, but each is on call to help Philips create intuitive, easy-to-use products that meet specific needs. "In the past, companies just developed the technology and hoped someone would buy it," says Ragnetti. "Now we are starting from the point of discovering what exactly consumers want a product to do."

'MIND-OPENING'

PHILIPS HAS GIVEN the board members free rein to kick the tires. When the consumer electronics unit was ready to launch its Wireless Audio Center, a system for listening to different tunes in multiple rooms around the house, Maeda gave it a whirl. His verdict: Too much computer jargon such as "booting up, please wait." "His suggestions were mind-opening," says Geert van Kuyck, Philips' senior vice-president of global marketing. Maeda's input "made us ask questions we hadn't asked before."

The outside perspective came in handy when assessing Philips' fast-growing medical business. As a practicing radiologist, Fritzsche noted that medical equipment is often too complex. Although the quality of images has grown dramatically, Fritzsche says the greater detail and quantity have increased the burden on radiologists. Offering so much data led to information overload instead of better diagnoses. With Fritzsche's insights, Philips is working to make its gear more intuitive, allowing doctors to spend more time with patients and less grappling with technology.

For Philips, the promise of simplicity isn't just about making products that are easier to use. The bigger challenge is rewiring the entire organization. The board's primary contribution, says Berman, is "using creative chaos to affect lasting change." That's trickier than it might sound. "Simplicity," says Maeda, "is actually a very complex topic." ■

Chocolate is tempting, but sugar-free chocolate hasn't always had the same attraction. Candy companies knew there was a pent-up demand for better-tasting sugar-free chocolate and asked Cargill to help create it. We combined our expertise in sugar replacers with our knowledge and passion for making chocolate to develop a sugar-free chocolate that was superior to anything before. Now candy makers and other food companies are using it to create new products that are winning consumers and rapidly growing the market for sugar-free chocolate. This is how Cargill works with customers.

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China's First Global Capitalist

by Steve Hamm and Dexter Roberts

ON A BRIGHT September afternoon, a black Mercedes S320 pulls up to a curb in the middle of Beijing's bustling Zhongguancun, the consumer-electronics shopping district. Out steps a man in a conservative gray suit, with ink-black hair, a round face, and wire-rim glasses. He still has the same youthful appearance he had 18 years earlier when, as a shy, bean-thin science student, he first arrived in this neighborhood. Then called Swindler's Alley, the area was a disreputable bazaar for knockoffs and black-market software. Now all that has been replaced by neon, steel, and glass.

Yang Yuanqing, 42, chairman of Lenovo Group Ltd., the leading PC company in China, steps into the Ding Hao Electronics Mall and a dizzying scene. Everywhere there are signs, lights, and swarms of shoppers. Strolling from one shop to another to peruse the displays of his company's devices, Yang, introduced by his handlers, speaks quietly with shopkeepers. But each time he stops, he is immediately surrounded by a scrum of people giddily snapping his picture with tiny digital cameras

Lenovo Chairman Yang Yuanqing is building a new breed of multinational

MARK LEONG/REDUX

CHINA'S BILL GATES Yang in the Beijing district where he started his career

and camera phones. Yang is a rock-star executive here, a Chinese Bill Gates.

It was in this neighborhood in 1988 that Yang began working for Lenovo—then a tiny company called Legend Group—in a nondescript three-story building. Yang slips back into the Mercedes and is soon gliding past the spot where he once bunked with four roommates in a company dormitory. Looking around, he realizes that the building has been demolished to make way for a parking lot. "Everything has been torn down," marvels Yang. "It's a total changeover."

Yang himself has undergone no less startling a transformation. He grew up poor in Hefei, a backwater city in eastern China, during the Cultural Revolution. Today he leads the world's third-largest PC company, with $13 billion in revenues. He's a rich globe-trotter: His compensation last year topped $2 million. He has a luxury apartment overlooking New York's Central Park and a home in suburban Beijing. In July, Yang moved his family for a few weeks to his apartment in Raleigh, N.C., near Lenovo's headquarters, so his kids could soak up American culture at summer camp. The Forbidden City meets Piggly Wiggly.

Last year, when Lenovo bought IBM PC Co., Yang stepped onto the world stage. He became the first Chinese executive to lead the takeover of an iconic Western business. In one swoop, he took on the world's leading technology companies. Now, as China's first truly global capitalist, he has a chance to help his homeland shed its image as a cheap manufacturing hub.

But Yang Yuanqing may turn out to be much more. From the moment he was tapped at age 29 to shake up the struggling PC unit of Lenovo's predecessor company, Yang has defied the stereotype of a Chinese manager. (That's assuming most American business managers can name even one leader of a Chinese company.) Today he is emerging as the first of a hybrid class of leader, marrying the drive and creativity of Western management with the vast efficiencies of China's manufacturing operations.

If your idea of a Chinese boss is a cautious bureaucrat propped up by the state, Yang is not that guy. He presides over a merit-based culture built on the Silicon Valley blueprint: In an elder-worshipping country, he fearlessly promotes young people and fires employees who aren't up to snuff. He demands that people learn from their mistakes, and he's relentless about self-improvement. When it became clear 18 months ago that he was being hindered by his scant knowledge of English, he hired a tutor, watched CNN obsessively, and went from halting to conversant within a year.

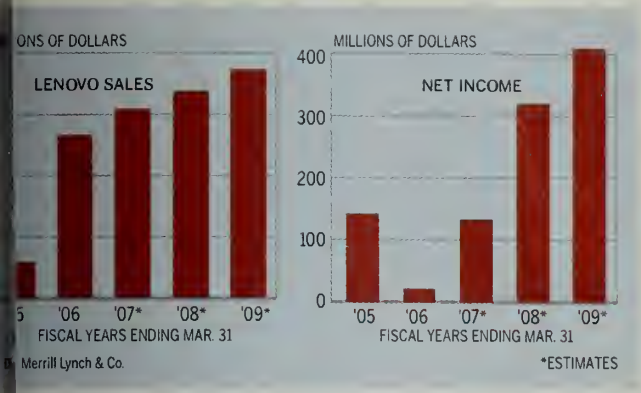
Some of Yang's management techniques would make Jack Welch proud. Shortly after rising to power at Legend, he decided managers needed to reconnect with their staff. Too many had highfalutin' titles with the equivalent of "president" in them; Yang wanted everybody addressed by their given name. To make the point, he ordered executives to stand outside the building every morning and greet workers while holding signs with their names written on them. "After two weeks, the change finally stuck," recalls Wang Xiaoyan, who is currently Lenovo's senior vice-president for information services.

The pressure on Yang is intense, and not just from shareholders. In the summer of 2005, a few months after IBM deal closed, Chinese Premier Wen Jiabao paid a visi Lenovo's Beijing offices. Yang showed him the latest PCs cell phones. As the short visit wrapped up, Wen told Ya "You carry the hopes of China on your shoulders," accorc to someone who was there.

But Yang is discovering just how hard it will be to trans success in China into success everywhere else. The honeym after the IBM PC purchase is long over. This spring, Yang into a buzz saw of Beltway politics when congressional cerns about security forced the State Dept. to change the it used some of the 14,000 PCs it had ordered from Len Responding to worries that Chinese government snoo technology could be tucked into the machines, the departm redirected some of them to less sensitive projects.

Lenovo: PC Giant Rising

WHAT IT IS: Lenovo Group was created in 1984 a Legend Group, one of China's first capitalist enterprises became the world's third-largest PC player when it bou IBM's PC operation in 2005. Today it is run by Chairma Yang and CEO William Amelio, a former Dell executive.



W IT'S DOING: Lenovo made only $22 million C6, the first year since the IBM acquisition. But analysts e efficiencies to click in and profits to grow.

AT IT SELLS: With a 35% market share, Lenovo ore PCs than anyone else in China, mostly through to consumers and small businesses. Outside China, npany has a 4.7% market share, mostly with large cations.

Data: IDC, Merrill Lynch & Co.

There has been plenty of friction inside Lenovo, too. Last cember, Yang and the board pushed out his second-in-nmand, former IBMer Steve Ward, in part because he s too slow to cut costs. Ward's replacement as CEO is the netic William J. Amelio, who formerly ran Asian operans for Dell Inc.

t's an oddball management setup. Yang runs the company, l Amelio reports to him. But they share a lot of responsibili- for overseeing this sprawling organization on a near-equal is. Lenovo sells products in no fewer than 66 countries l develops them at labs in China, the U.S., and Japan. Yang l Amelio also must mix the best people and traits of the old ovo with those of IBM. In essence, they're blending two ional cultures and, to add to the stress, three corporate s, since Amelio has been replacing some of the top executives from Lenovo and IBM with his own team, mostly from Dell. Rarely if ever has a corporate leader had to manage such a tangled web of relationships.

Yang answers to an odd mix of shareholders that includes public investors, the Chinese Academy of Sciences, the company's founders, and IBM. Each constituency has its own ax to grind. Private equity investors hold a lot of clout, having sunk $350 million into the company for a 10% stake. Board members William O. Grabe of General Atlantic and James G. Coulter of Texas Pacific Group early on pressed for faster cost-cutting and more decisive decision-making. "This is an unusual melding of what had been a Chinese company, IBM, and some very strong-willed U.S. investors," says Coulter.

Yang's strategy is ambitious. Over the next couple of years, he wants to boost Lenovo's already dominant 35% market share in China while expanding to other emerging markets. In the West, he taps IBM for help in selling to large corporations. But for small and midsize businesses, Lenovo is now mimicking its China strategy and offering a new line of PCs through a host of retailers. Meanwhile, the company is retooling the old IBM PC Co. manufacturing supply chain to make it as efficient as Lenovo's China operations. "We want to extend the business model that was so successful in China out across the world," Yang says.

In the long term, Yang aims to turn Lenovo into a high-profile global brand. He took the first huge step in 2004 when he inked a deal with the International Olympic Committee to be the tech sponsor of the Turin and Beijing Olympic Games. After the merger was completed, he challenged company engineers to come up with a string of hit products for businesses and consumers worldwide in advance of the Beijing event.

At the same time, Lenovo is weaning customers off the IBM brand, which it has the right to use for five years. First, it stopped using IBM in advertising. Now it's gradually shifting the branding on ThinkPad laptop computers to remove IBM and replace it with Lenovo.

Former IBM engineers say things have changed for the better since the merger—and in ways you might not expect. Yang has kept research and development spending constant as a percentage of revenues. But because more of the work is being done in China, where engineers cost one-fifth what they do in the U.S., he gets more bang for the buck. He has also dedicated 20% of his R&D budget for cutting-edge ideas. Under U.S. management, the unit had become focused largely on cost-cutting. "It used to be, 'Can we save a penny?' Now it's, 'What new ideas do you have?'" says David Hill, executive director for corporate identity and design. One novel concept already has come from the Beijing engineers: NovaCenter, a living-room-style combination of PC and TV that's now selling in China. In addition to Microsoft's Windows, it has an entertainment-oriented operating system that was created by Lenovo.

For all its big plans and lofty ambitions, though, Lenovo remains in a precarious position. Sales are still strong in China, which is expected to be one of the fastest-growing markets in coming years. However, Lenovo is up against companies several times its size. Dell alone has sunk $16 billion into Chinese factories and suppliers over the past year—more than Lenovo's worldwide sales. Lenovo's sales declined by 9% in the U.S. last quarter, signaling that the company is struggling in its efforts to build a global brand. Analysts are troubled by that report, though they expect efficiencies and revenue growth to

click in over the long term. The stock (which doesn't trade on U.S. exchanges) is priced around HK$3.30, having zigzagged between $2 and $4 for three years. In September, Lenovo was dropped from the Hong Kong Exchange's Hang Seng Index because of slack trading volumes.

Other Chinese business kingpins are watching closely to see if Yang stumbles. With a domestic economy growing at 10% per year and foreign reserves topping $1 trillion soon, they are hungrily eyeing attractive overseas takeover targets—everything from oil to consumer electronics. But China's early forays into global expansion have been frustrating. Electronics maker TCL Corp.'s 2004 joint venture with France's Thomson, which owns the famed RCA brand, has bled cash, resulting in shuttered plants and offices. And in 2005 an $18.5 billion bid by CNOOC Ltd. for Unocal never got off the ground; the U.S. Congress put the kibosh on it. Many Chinese executives want to see how Yang does before they, too, plunge into globalization.

Edward Tian, a friend of Yang's and former vice-chairman of telecommunications giant China Netcom Group, explains how others view the Lenovo executive: "In China there's an old saying, 'Don't be the first one to eat the crab.' It's difficult to get the meat out, and you might be poisoned. People see Yuanqing as the guy eating the crab. They're waiting to see if he'll survive."

If Lenovo fizzles, it won't be for lack of intensity. Former IBMers agree that the pace of business and decision-making has picked up since Yang took over. That's visible in the massive third-floor atrium of the Lenovo Building in Beijing's sprawling Shangdi Information Industry Base, where a huge billboard with a map of China is divided into 18 sales regions. Across the bottom are columns showing the sales and ranking of each region. Every day at 7:30 p.m., totals are tallied and messages go out to all of the managers' mobile phones. If a region comes in with less then 100% of its quota, its manager immediately must produce a plan for turning things around.

Sometimes, Yang seems obsessed with details. Before formal dinners, he personally reviews seating arrangements to make sure all protocols are being followed. Last year, during a ceremony launching a summer camp program for kids at Lenovo Beijing, he noticed that the Lenovo flag was attached upside down on a flagpole. To get the attention of the events team, he docked their performance bonuses.

Figuring out exactly what role Yang should play in the company has been tricky. He engineered the IBM acquisition, yet during the transition seemed to fade into the background. Ward became the company's front man with the Western press and analysts. Although Ward and Yang deny there was ever any tension between them, one industry bigwig recalls that when he had dinner with the two a few months after the deal closed, Ward did nearly all of the talking. "It was really an uncomfortable situation," he says.

Initial encounters between Yang and Amelio were also tense. No wonder: They had been head-to-head competitors in the China market. Amelio recalls their first awkward one-on-one session at a Hong Kong hotel: "Here we were, two guys who have been trying to slit each other's throats talking about doing something together."

At their second meeting, Yang surprised Amelio by pulling out a single sheet of paper listing the roles for Lenovo's chairman and CEO. His job included setting corporate and technology strategy and communicating with investors. Amelio's main task was running the PC business day-to-day. This is not the typical split between chairman and CEO—Yang would be much more hands-on, like a co-CEO. Amelio went along without complaint. "I was surprised that he agreed so quickly," says Yang. "He looked at it for three minutes and said, 'O.K.' "

Now they're a tag team. Yang goes deep on his specialties, which include marketing and distribution. Last July, for instance he spent two days in Stuttgart, brainstorming with a dozen European salespeople about how to radically make over the way the company plans and prices products in Central Europe. Elements of the new program were launched within two weeks. Longtime IBMer Robert Pasquier, now Lenovo's distribution director for Central Europe, was impressed that Yang was willing to get his hands dirty. He says the company has been transformed culturally since Lenovo took over: "There's more of a sense of urgency with everyone. It used to be we felt pressure only at the end of the year, but now we feel it every month. People want to win."

> Yang's confidence has grown of late. "The Chinese PC market used to be dominated by state-owned enterprises," he says. "We beat them all."

Amelio, meanwhile, concentrates on fine-tuning the supply chain. "Bill often calls me boss, but I don't want to put myself only in the boss position," says Yang. "I want to contribute more to the company at all levels." Still, Yang's influence has grown over the past year. Shortly after the IBM PC takeover, the board created a powerful strategy committee headed by Yang but packed with other strong voices, including company co-founder Liu Chuanzhi. At first, the committee met monthly; now, it meets just once a quarter. "Today, Yang is the guy who runs the strategy and sets the agenda," says General Atlantic's Grabe.

A confident Yang has emerged as more of a public figure in the West. And he has become more outspoken. Yang was irate during the dustup over the State Dept. computer order. "We are not a government-controlled company," he insisted in a phone call placed to a *BusinessWeek* reporter shortly after the matter came to a head. "The Chinese PC market used to be dominated by state-owned enterprises. We beat them all." Today, the state-run Chinese Academy of Sciences holds 27% of Lenovo's shares, thanks to its early $25,000 investment in Legend. (That compares with 35% for public shareholders, 15% for employees, 13% for IBM, and 10% for private investors.) But the academy has no members on the board, and the company insists it exerts no influence.

Later, Yang made his case directly to Congress on a swing through Capitol Hill. Last June, at a business conference in San Francisco, he switched name tags at a table so that he could sit next to C. Richard D'Amato, a member of the congressional advisory committee that had raised the security concerns. D'Amato says he was impressed with Yang's earnestness, but "nothing really changed my thinking."

NETIME RIVAL
EO William
nelio assembled
eam of former
ell colleagues

Yang was more successful in brokering a deal to help rein PC software piracy in China. Microsoft had been struggling for years to get Chinese computer users to pay for ware, yet most of them still bought PCs that didn't include dows and later loaded illegal copies on their machines. uly, 2005, during a meeting at Microsoft headquarters Redmond, Wash., Gates and Microsoft Chief Executive en A. Ballmer asked Yang for help with piracy, and, over next few months, Yang worked out a deal with Micro- China executives. They agreed to give him a rebate on dows and marketing help in exchange for him agreeing ad it on most Lenovo PCs sold in China. Yang gambled other Chinese makers would follow suit, and, thanks to sure from the government, they did. Microsoft's sales Vindows shipped on PCs in China have tripled since the l came together last fall. Says Ballmer: "Yuanqing made a e difference. He was willing to go out on a limb."

ut if Yang is more of a risk taker than one might expect of rson who grew up in a communist state, his style is also ly calculated. Lenovo colleagues who have spent evenings Yang playing Tuolaji, a Chinese card game, say he studies cards for a long time before making a move. Even when t a bad hand, he tries to figure out a way to win. They see llels in how Yang runs the company: He's willing to take s, but only if he has thoroughly studied a situation and res he has a reasonable chance of prevailing.

's no mystery where these traits come from. Yang recalls parents as tough taskmasters who demanded that he study l and rank at the top of his classes. Both were surgeons, yet in 1960s China they were paid the same as manual laborers and repeatedly sent to the countryside for reeducation and community service.

That forced Yang to grow up fast. Starting at age 8, he cooked meals over a smoky coal fire for himself and two younger siblings on the balcony of the brick housing project where the family lived in a cramped apartment. Yang's only toy was a bag of marbles; if he wanted to play ball, he'd scrunch up a cast-off cigarette package. His mother, Wang Biqin, gave him a tiny allowance each month, but he rarely spent it because he knew that she might have to take it back to buy food. Yang knew nothing of the outside world. "It was a tragedy, but it was also lucky," he says, looking back. "If you don't know what's going on outside, you don't know what you're missing."

Contrast hardscrabble Hefei in the 1960s with Yang's life today. In August he moved his parents, wife, and three children into a Raleigh apartment inside a gated community amid rolling, wooded countryside. On a steamy summer day, the Yangs gather excitedly in the living room around a low glass table spread with fresh fruit and cookies—which the children don't touch. Yang proudly prompts his eldest boy, Yang Yiqi, 11, to list the three goals he had been assigned when he went off to American summer camp. They were: learn English, make new friends, and excel at sports. "And did you reach your target?" Yang asks. The boy's enthusiastic answer: "Yes, I did!"

When asked what Yang was like when he was growing up, his father, Yang Furong, launches into a long tale that makes the whole family chuckle knowingly. Yang studied ferociously for the national university entrance exams. One evening, he accompanied the rest of the family on a rare outing to a movie theater, but when the house lights came up at the end, they discovered that his seat was empty. In mid-movie, he had raced back home to study.

Yang loved reading literature and writing poetry as a teenager, but pursued a computer science degree at university on the advice of a professor friend of his parents. Six years later he was studying in Beijing to finish up his master's degree in computer science and was headed for an academic career when he spotted an ad for a job at Legend in a newspaper. At the time it was a 100-person company that sold Sun Microsystems and Hewlett-Packard computers at retail. Yang signed on as a salesman at one of the few truly market-driven companies in all of China. His pay: $30 a month.

It was a fortuitous choice. Legend's chief executive, Liu, had emerged in the 1980s as one of modern China's first real entrepreneurs. He and 10 other researchers at the science academy formed the company in 1984. Legend had a rocky first few years, but, by the time Yang landed there, it seemed to be on solid footing. He excelled as a salesman, and Liu eventually put him in charge of small businesses and then the company's crucial engineering workstation unit. There, he got to know Americans who worked for Sun and HP, and he scarfed up every bit of knowledge he could about how to run a successful business.

A pivotal moment came in 1994. Liu was laid up in a Beijing

hospital suffering from exhaustion and stress. Legend had begun selling its own PCs in 1990, but, when China opened the market to direct imports by foreign PC giants, it was caught in a pincer. As a publicly held company, Legend did not receive government support like state-owned PC outfits. Yet it didn't have the financial strength of foreign PC makers. Flat on his back for weeks, Liu used the time to consult with his underlings. He came away impressed with the youthful Yang's knowledge of the PC business and his Boy Scout-style honesty—not a small consideration at a time when Chinese enterprises were rife with corruption. Upon leaving the hospital, Liu decided to stay in PCs and create a separate division with the 29-year-old Yang in charge.

What Yang accomplished far exceeded Liu's expectations. In just three years he transformed Legend from an also-ran into the leading PC player in China. He switched from using only a direct sales force to also selling through a vast network of retailers. And he focused on innovation. Until then, the technology in PCs sold in China had been a generation behind those sold in the West. Legend shipped PCs based on Intel's new Pentium processor at the same time they were shipped in North America. Yang also opened up the now-vast consumer market with low-cost, super-easy-to-use PCs. One Legend model let PC novices set up an Internet connection with a single push of a button.

Along the way, Yang learned management lessons that would later prove vital. As the new boss of the PC Div., he supervised several of the company's founders. That was hard for them to swallow. To make matters worse, Yang didn't have a diplomatic sinew in his body. He fired half of the staff, forced managers to radically alter the way they did business, bawled out people when they screwed up, and ignored criticism. It was not very Chinese of him. Liu saw that he very nearly had a revolt on his hands, so he called a management meeting to deal with it. "I criticized Yang so severely he almost broke down in tears," recalls Liu. "But this had a good effect... He started to change his work style."

While Yang became more diplomatic, he remained a reformer. When the PC Div. switched buildings in 1997, he used the move to break with the past. He insisted on a more formal dress code and trained all employees in phone etiquette. This is when he made everyone start referring to managers by their given names.

It wasn't until later that Legend employees understood what Yang was up to. He wanted Legend managers and employees to think and act like techies in Silicon Valley, Boston, or Berlin. Yang knew that unless Legend expanded beyond the borders of China, it would not be able to match the clout of the foreign PC giants. So, when Liu handed the CEO job to him in 2001, Yang made globalization one of his long-term goals.

His big opportunity came in 2003, when he learned that IBM was interested in selling off its large but money-losing PC unit as part of its move to services. Yang saw this deal as a way for Legend, which was about to rebrand itself as Lenovo, to leap onto the world stage without having to grind it out country by country. But the entire board of directors lined up against Yang. Think about what he was asking the Lenovo elders to do: A $[illegible] billion company based in China would be taking over a $10 billion global behemoth. IBM had practically invented the PC industry; if Big Blue couldn't make money selling these machines worldwide, how could little Lenovo hope to do any better? "We had all built this company, and nobody wanted to take such a big risk," explains Liu.

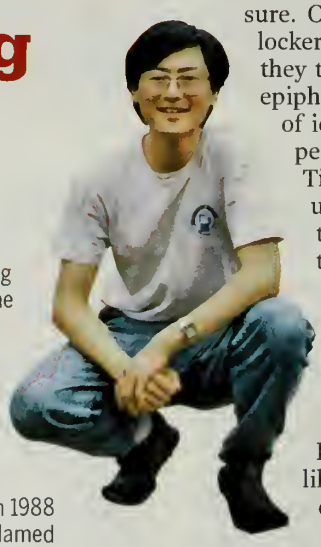
Yang and his team dug in. They made presentation after presentation to the board until the endless meetings took on the feel of a court trial. Yang was under extreme pressure. One day, when Yang was venting to him in the locker room after a workout, his friend Tian suggested they take a sauna to relax. Yang had something of an epiphany after the two men jumped, naked, into a pool of icy water. "Suddenly Yuanqing was not a serious person anymore. He smiled like a baby," recalls Tian. Eventually, Yang prevailed. He agreed to give up the CEO role to a more worldly Western executive and convinced the board that he could make the former IBM operations more profitable.

Today, Yang's moments of pure bliss are rare. At the end of a long workday in September he sits at a table in the Bai Family Courtyard Restaurant in Beijing—a setting as far from the smoky balcony in Hefei as you could imagine. The restaurant is decorated in the style of Beijing's Imperial Palace, and the waitresses dress like Qing Dynasty princesses in elaborate hemmed dresses and lavishly embroidered silk clothing. They bring dish after exquisite dish, an overabundance that seems designed to make up for the privations of China's past.

For a moment, Yang appears relaxed. But that's only temporary. A guest asks what keeps him up at night, and Yang quickly answers: almost everything. "I have a lot of anxiety dreams," he says. "It's the normal emergencies of running a company every day. A customer complains. We're not able to meet demand. There's a shortage of parts. I often wake up, sometimes I'm up all night." ■

Yang Yuanqing

Chairman, Lenovo Group



BIRTHDAY Nov. 12, 1964

PLACE Hefei, Anhui Province, People's Republic of China

CHILDHOOD Both parents were surgeons. During the Cultural Revolution they were repeatedly sent to the countryside for reeducation and community service. Yang loved poetry as a teenager but pursued computer science at university.

EDUCATION Bachelor's degree, 1986, Shanghai Jiaotong University; master's degree, 1989, University of Science & Technology of China, Hefei.

CAREER Joined Legend in Beijing as a salesman in 1988 and quickly became a manager of small businesses. Named head of the fledgling PC unit in 1994 and turned it into the No. 1 player in China in 1997. Named chief executive in 2001.

FAMILY Met his wife, Medea Q. Ming, in college and married her in 1997. The couple has three children. Yang recently took an apartment in Raleigh, N.C., to be nearer the old IBM PC operations.

FAVORITE CHINESE POET Xu Zhimo, who was born in China but traveled to America in 1918 to study at Columbia University.

LAST BOOK READ *The World is Flat* by Thomas Friedman.

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NO FIXED SCHEDULES.
NO MANDATORY MEETINGS.
INSIDE BEST BUY'S RADICAL RESHAPING OF THE WORKPLACE

Smashing The Clock

BY MICHELLE CONLIN

ONE AFTERNOON LAST YEAR, CHAP ACHEN, WHO OVERSEES online orders at Best Buy Co., shut down his computer, stood up from his desk, and announced that he was leaving for the day. It was around 2 p.m., and most of Achen's staff were slumped over their keyboards, deep in a post-lunch, LCD-lit trance. "See you tomorrow," said Achen. "I'm going to a matinee."

Under normal circumstances, an early-afternoon departure would have been totally un-Achen. After all, this was a 37-year-old corporate comer whose wife laughs in his face when he utters the words "work-life balance." But at Best Buy's Minneapolis headquarters, similar incidents of strangeness were breaking out all over the ultramodern campus. In employee relations, Steve Hance had suddenly started going hunting on workdays, a Remington 12-gauge in one hand, a Verizon LG in the other. In the retail training department, e-learning specialist Mark Wells was spending his days bombing around the country following rocker Dave Matthews. Single mother Kelly McDevitt, an onl promotions manager, started leaving at 2:30 p.m. to pick her 11-year-old son Calvin from school. Scott Jauman, a Sigma black belt, began spending a third of his time at Northwoods cabin.

At most companies, going AWOL during daylight ho would be grounds for a pink slip. Not at Best Buy. T nation's leading electronics retailer has embarked on a ra cal—if risky—experiment to transform a culture once kno for killer hours and herd-riding bosses. The endeavor, cal ROWE, for "results-only work environment," seeks to molish decades-old business dogma that equates phys presence with productivity. The goal at Best Buy is to ju performance on output instead of hours.

Hence workers pulling into the company's amenity-pac headquarters at 2 p.m. aren't considered late. Nor are th pulling out at 2 p.m. seen as leaving early. There are no sch ules. No mandatory meetings. No impression-managem

LAID BACK
Wells, an avid bicyclist, likes to sleep in late and doesn't own an alarm clock

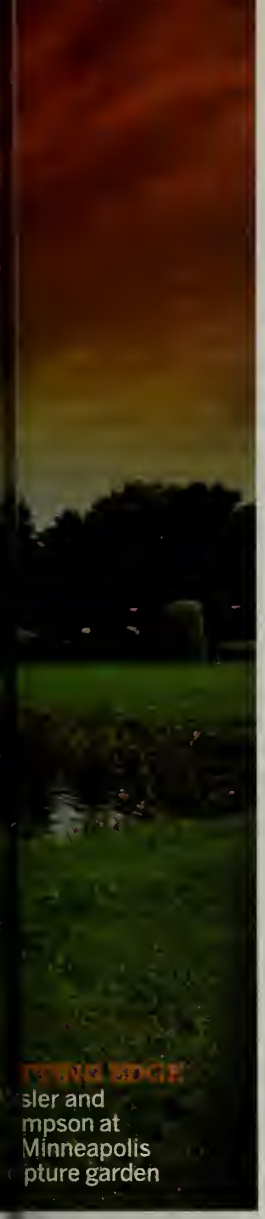
BEST BUY'S 'RESULTS-ONLY WORK ENVIRONMENT' MEASURES PERFORMANCE BASED ON OUTPUT, NOT HOURS. YOU DON'T PHYSICALLY HAVE TO BE AT WORK

hustles. Work is no longer a place where you go, but something you do. It's O.K. to take conference calls while you hunt, collaborate from your lakeside cabin, or log on after dinner so you can spend the afternoon with your kid.

Best Buy did not invent the post-geographic office. Tech companies have been going bedouin for several years. At IBM, 40% of the workforce has no official office; at AT&T, a third of managers are untethered. Sun Microsystems Inc. calculates that it's saving $300 million a year in real estate costs by allowing nearly half of all employees to work anywhere they want. And this trend seems to have legs. A recent Boston Consulting Group study found that 85% of executives expect a big rise in the number of unleashed workers over the next five years. In fact, at many companies the most innovative new product may be the structure of the workplace itself.

But arguably no big business has smashed the clock quite so resolutely as Best Buy. The official policy for this post-fa time, location-agnostic way of working is that people are f to work wherever they want, whenever they want, as long they get their work done. "This is like TiVo for your wor says the program's co-founder, Jody Thompson. By the en 2007, all 4,000 staffers working at corporate will be on RO Starting in February, the new work environment will beco an official part of Best Buy's recruiting pitch as well as orientation for new hires. And the company plans to take clockless campaign to its stores—a high-stakes challenge no company has tried before in a retail environment.

Another thing about this experiment: It wasn't impo from the top down. It began as a covert guerrilla action spread virally and eventually became a revolution. So se was the operation that Chief Executive Brad Anderson learned the details two years after it began transform



sler and
mpson at
Minneapolis
pture garden

his company. Such bottom-up, stealth innovation is exactly the kind of thing Anderson encourages. The Best Buy chief aims to keep innovating even when something is ostensibly working. "ROWE was an idea born and nurtured by a handful of passionate employees," he says. "It wasn't created as the result of some edict."

So bullish are Anderson and his team on the idea that they have formed a subsidiary called CultureRx, set up to help other companies go clockless. CultureRx expects to sign up at least one large client in the coming months.

The CEO may have bought in, but there has been plenty of opposition inside the company. Many execs wondered if the program was simply flextime in a prettier bottle. Others felt that working off-site would lead to longer hours and destroy forever the demarcation between work and personal time. Cynics thought it was all a PR stunt dreamed up by Machiavellian operatives in human resources. And as ROWE infected one department after the other, its supporters ran into old-guard saboteurs, who continue to plot an overthrow and spread warnings of a coming paradise for slackers.

Then again, the new work structure's proponents say it's ...ing Best Buy overcome challenges. And thanks to ...y successes, some of the program's harshest critics have ...me true believers. With gross margins on electron... under pressure, and Wal-Mart Stores Inc. and Target ...o. shouldering into Best Buy territory, the company has ...n moving into services, including its Geek Squad and ...stomer centricity" program in which salespeople act as ...nology counselors. But Best Buy was afflicted by stress, ...nout, and high turnover. The hope was that ROWE, by ...ing employees to make their own work-life decisions, ...d boost morale and productivity and keep the service ...ative on track.

... seems to be working. Since the program's implemen...n, average voluntary turnover has fallen drastically, ...ureRx says. Meanwhile, Best Buy notes that productivity ...o an average 35% in departments that have switched to ...VE. Employee engagement, which measures employee ...sfaction and is often a barometer for retention, is way ...poo, according to the Gallup Organization, which audits ...orate cultures.

...OWE may also help the company pay for the customer ...ricity campaign. The endeavor is hugely expensive because ...volves tailoring stores to local markets and training em...ees to turn customer feedback into new business ideas. By letting people work off-campus, Best Buy figures it can reduce the need for corporate office space, perhaps rent out the empty cubicles to other companies, and plow the millions of dollars in savings into its services initiative.

Phyllis Moen, a University of Minnesota sociology professor who researches work-life issues, is studying the Best Buy experiment in a project sponsored by the National Institutes of Health. She says most companies are stuck in the 1930s when it comes to employees' and managers' relationships to time and work. "Our whole notion of paid work was developed within an assembly line culture," Moen says. "Showing up was work. Best Buy is recognizing that sitting in a chair is no longer working."

One giant wireless kibbutz

JODY THOMPSON AND CALI Ressler are two HR people you actually don't hate. They groan over cultish corporate slogans like "Build Superior Organizational Capability." They disdain Outlook junkies who double-book and showboating PowerPointers. But it's flextime, or Big Business' answer to overwork, long commutes, and lack of work-family balance, that elicits the harshest verdict. "A con game," says Thompson. "A total joke," adds Ressler.

Flexible work schedules, they say, heap needless bureaucracy on managers instead of addressing the real issue: how to work more efficiently in an era of transcontinental teams and multiple time zones. They add that flextime also stigmatizes those who use it (the reason so few do) and keeps companies acting like the military (fixated on schedules) when they should behave more like MySpace (social networks where real-time innovation can flourish). Besides, they say, if people can virtually carry their office around in their pockets or pocketbooks, why should it matter where and when they work if they are crushing their goals?

Thompson, 49, and Ressler, 29, met three years ago. The boomer and the Gen Xer got each other right away. When they talk about their meeting, it sounds like something out of *Plato for HR*, or two like minds making a whole. At the time, Best Buy was still a ferociously face-time place. Workers arriving after 8 a.m. on sub-zero mornings stashed their parkas

Off The **Leash**

What happened when Best Buy allowed staff to work wherever and whenever they want

VOLUNTARY TURNOVER SINCE 2005 (DIVISION)

DOT-COM **–90%** | LOGISTICS **–52%**

SOURCING **–75%**

AVERAGE RISE IN ROWE WORKER PRODUCTIVITY SINCE 2005

+35%

in their cars to foil detection as late arrivals. Early escapees crept down back stairwells. Cube-side, the living was equally uneasy. One manager required his MBAs to sign out for lunch, including listing their restaurant locations and ETAs. Another insisted his team track its work—every 15 minutes. As at many companies, the last one to turn out the lights won.

Outside the office, Thompson and Ressler couldn't help noticing how wireless broadband was turning the world into one giant work kibbutz. They talked about how managers were mired in analog-age inertia, often judging performance on how much they saw you, vs. how much you did. Ressler and Thompson recognized the dangerous, life-wrecking cocktail in the making: The always-on worker now also had to be always in.

The culture, not exactly Minnesota-nice, was threatening Best Buy's massive expansion plans. But Ressler and Thompson knew their solution was too radical to simply trot up to CEO Anderson. Nor, in the beginning, did they feel they could lobby their executive supervisors for official approval. Besides, they knew the usual corporate route of imposing something from the top down would bomb. So they met in private, stealthily strategizing about how to protect ROWE and then dribble it out under the radar in tiny pilot trials. Ressler and Thompson waited patiently for the right opportunity.

It came in 2003. Two managers—one in the properties division, the other in communications—were desperate. Top performers were complaining of unsustainable levels of stress, threatening business continuity just when Best Buy was rolling out its customer centricity campaign in hundreds of stores. They also knew from employee engagement data that workers were suffering from the classic work-life hex: jobs with high demands (always-on, transcontinental availability) and low control (always on-site, no personal life).

Ressler and Thompson saw their opening in these two vanguard managers. Would they be willing to partake in a private management experiment? The two outlined their vision. They explained how in the world of ROWE, there would be no mandatory meetings. No times when you had to physically be at work. Performance would be based on outp not hours. Managers would base assessments on data a evidence, not feelings and anecdotes. The executives lil what they heard and agreed.

The experiment quickly gained social networking h Waiting in line at Best Buy's on-site Caribou Coffee, in e-ma and during drive-by's at friends' desks, employees in ot parts of the company started hearing about this seeming a dote to megahour agita. A curious culture of haves and ha nots emerged on the Best Buy campus, with those in RO sporting special stickers on their laptops as though t were part of some cabal. Hance, the hunter, started tak conference calls in tree stands and exchanging e-mails fi

Flextime: Honing the Balance

Woody Allen famously said that 80% of success is showing up. That's no joke in the corporate world. Show up early. Stay late. Look busy. Acting the part of the devoted employee has earned many a middling performer solid reviews.

Flextime agreements, combined with a greater focus on performance metrics, were supposed to help change all that. As of last year, says human resources consulting firm Hewitt Associates Inc., 75% of companies offered some kind of flexible work arrangement. But so far, these policies have had mixed results. Working remotely can leave employees feeling isolated and managers feeling they lack control. And flextimers often find themselves squeezed into policies that are anything but flexible. "The work-life movement has always had a heavy layer of one-size-fits-all-ism," says Stewart D. Friedman, who runs the Work/Life Integration Project at the Wharton Scho

That complaint is prompting many companies to revamp their policies, sa Hewitt's Carol Sladek, who leads the fir work-life practice. Now more and more managers are using a template of ques to help them design the most fitting arrangement. "There's definitely a focu away from the structure" of rigid flextir policies, says Sladek.

In a sense, flexibility is becoming more flexible. At Deloitte & Touche, yea of stagnant enrollment in formal flexibil programs have led managers to help tea create flexible schedules among themsv Staffers fill out a survey that helps the set goals as a group (reducing the nun of times they interrupt co-workers off- hours, for instance) and jointly keep tr of people's schedules so they know, sa when someone has reserved time wit their kids. Deloitte is also experimenti with something called "mass career

omization" that redefines flexibility the course of a career rather than by hours in a week, helping employees st their pace, workload, schedule, and roles during various life stages.

nother common complaint from early ility adopters is that the off-site ence can be a real morale killer. found that out the hard way. e the company had saved millions al estate costs by getting 40% workers to toil off-site, by 2002, y of its telecommuters felt out of oop. Just over half of the folks in el S. Pelino's central region reported rable levels of engagement. "People felt y disconnected," says Pelino, now general ager of IBM's Global Health Care & Life nces business.

response, Pelino started an initiative, ing IBM Feel Small," to reconnect remote ers. Nomads who drop by the office now a space designed with their needs ind. Faxes and copiers are in liar spots from one office to her, and conference room s have been replaced with s so colleagues will know n their co-workers are te. After Pelino brought the initiative to senior management, IBM revitalized IBM Clubs, which bring together colleagues for parties, picnics, sports events, and other extracurricular activities. Making IBM Feel Small has since spread to more than 33 locations worldwide.

Over at Sun Microsystems Inc., another flextime pioneer, managers found the company's "Open Work" program could be, well, too open. About four years ago, as better communications technology attracted more people to the program, a growing number of employees began electing to work from home without checking with their bosses. "A lot of managers were uncomfortable with 'out of sight, out of mind,'" says Ann Bamesberger, the vice-president leading the program. In response, her team added an online test that helps managers find good candidates for the program. Employees are assigned broad profiles that reflect how they work, including such nicknames as "Mobile Collaborator" or "Design Specialist." Managers and their reports are expected to hash out a solution that offers flexibility and control. "There are certain types of jobs where a free-for-all doesn't work," says Bamesberger. Then she catches herself, warning: "A free-for-all never works." *–Jena McGregor*

fishing boat. When Wells wasn't following around Dave thews, chances were he was biking around Minneapolis' work of urban lakes, and digging into work only after t had fallen. Hourly workers were still putting in a full but began doing so wherever and whenever they wanted. t first, participants were loath to share anything about VE with higher-ups for fear the perk would be taken y or reversed. But by 2004, loftier and loftier levels of agement began hearing about the experiment at about ime opposition to it grew more intense. Critics feared exives would lose control and co-workers would forfeit the aboration born of proximity. If you can work anywhere, asked, won't you always be working? Won't overbearing bosses start calling you in the middle of the night? Won't coasters see ROWE as a way to shirk work and force more dedicated colleagues to pick up the slack? And there were generational conflicts: Some boomers felt they'd been forced to choose between work and life during their careers. So everyone else should, too.

Shari Ballard, Best Buy's executive vice-president for human capital and leadership (an analog title if ever there was one), was originally skeptical, although she eventually bought in. At first she couldn't figure out why managers needed a new methodology to help solve the work-life conundrum. "It wasn't hugs and smiles," she says of Ressler's and Thompson's campaign. "Managers in the old mental model were totally

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Sun microsystems share

NO EDICTS CEO Anderson praises the stealth rollout of the new work structure

PLAYBOOK: BEST PRACTICE IDEAS

Let Them Go

Tips for creation of a post-geographic workplace

MEASURE
Before unplugging workers, metrics are key to ensure that productivity, engagement, and turnover improve.

TAILOR
Imposing new work rules rarely pays because managers and workers need to tailor schedules to their needs.

TRUST
Inevitably, some untethered workers will slack off. Managers need to trust—then rely on data to assess performance.

EDUCATE
Location-agnostic work is a hard concept to grasp. So refresher courses are a must for managers and workers.

GATHER
When workers are nomads, regular gatherings, in person or by videoconference, help retain a team dynamic.

irritated." In the e-learning division, many of Wells's older co-workers (read 40-year-olds; the average age at Best Buy is 36) expressed resentment over the change, insisting that work relationships are better face-to-face, not screen-to-screen. "We have people in our group who are like, 'I'm not going to do it,'" says Wells, who likes to sleep in and doesn't own an alarm clock. "I'm like, 'that's fine, but I'm outta here.'" In enemy circles, Ressler and Thompson are known to this day as "those two" and "the subversives."

Yet ROWE continues to sprea through the company. If intrigue nonparticipants work for progressiv superiors, they usually talk up th program and get their bosses to agre to trials. If they toil under clock-watchers, they form unde ground networks and quietly lobby for outside support unt there is usually no choice but for their boss to switch. It wa only this past summer that CEO Anderson got a full briefin and total understanding, about what was happening. "W purposely waited until the tipping point before we took it t him," says Thompson. Until then he wasn't well-versed c the 13 ROWE commandments. No. 1: People at all levels sto doing any activity that is a waste of their time, the custome time, or the company's money. No. 7: Nobody talks abo how many hours they work. No. 9: It's O.K. to take a nap on Tuesday afternoon, grocery shop on Wednesday morning, catch a movie on Thursday afternoon.

That's the commandment Achen was following when l took off that day to see *Star Wars Episode III: Revenge of t Sith.* Doing so felt abnormal and uncomfortable. Achen f guilty. But Ressler and Thompson had told him to "model t behavior." So he did. It helped that Achen saw in ROWE t potential to solve a couple of nagging business problems... the head of the unit that monitors everything that happe after someone places an order at BestBuy.com, includi manually reviewing orders and flagging them for possi fraud, Achen wanted to expand the hours of operation wi out mandating that people show up in the office at 6 a.m... had another issue. One of his top-performing managers liv in St. Cloud, Minn., and commuted two and a half hours ea way to work. He and Achen had a gentleman's agreem that he could work from home on Fridays. But the rest of t staff didn't appreciate the favoritism. "It was creating a lo tension on my team," says Achen.

Record job satisfaction

RESSLER AND THOMPSON had convinced Achen that RO would work. Now Achen would have to convince the gen manager of BestBuy.com, senior vice-president John "J Thompson. That wasn't going to be easy. Thompson, a mer General Electric Co. guy, was as old school as they co with his starched shirt, booming voice, and ramrod-strai posture. He came of age believing there were three 8-h days in every 24 hours. He loved working in his office weekends. At first, he pushed back hard. "I was not supp ive," says Thompson, who was privately terrified about loss of control. "He didn't want anything to do with it," Achen. "He was all about measurement, and he kept ask me, 'How are you going to measure this so you know yo getting the same productivity out of people?'"

That's where Achen's performance metrics came in ha He could measure how many orders per hour his team processing no matter where they were. He told Thomp he'd reel everyone back to campus the minute he notic dip. Within a month, Achen could see that not only was team's productivity up, but engagement scores, or measu job satisfaction and retention, were the highest in the com division's history.

For years, engagement had been a sore spot for Thomp "I showed J.T. these scores, and his eyes lit up," says Ac

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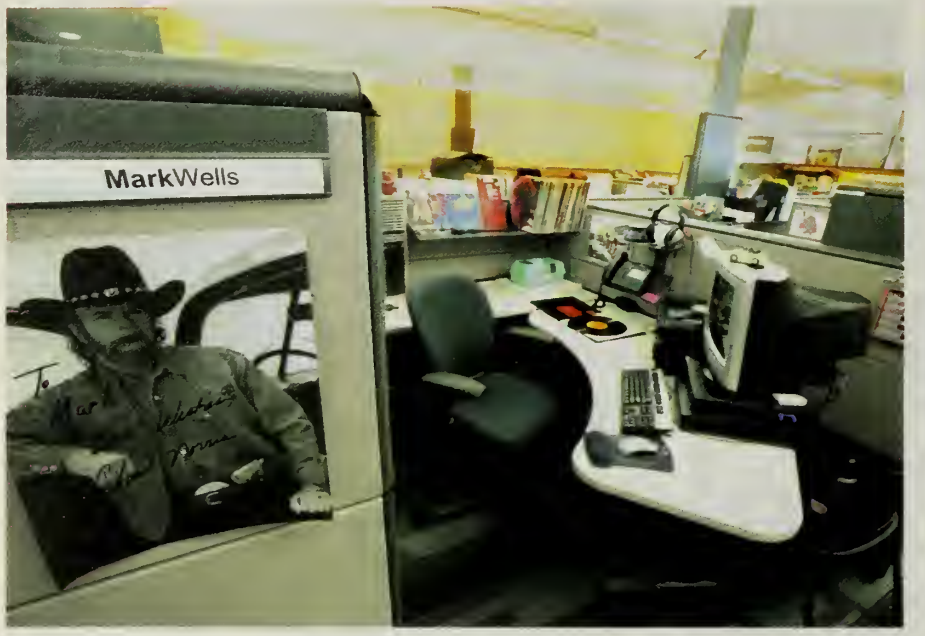

EMPTY CUBE Best Buy workers like Wells are free to work wherever, whenever they want—as long as the work gets done

IF BUSINESS GOES SOUTH, DOUBTERS MAY SEE AN OPPORTUNITY TO TRY TO FORCE A HASTY RETREAT

Thompson rushed to roll out ROWE to his entire department. Voluntary turnover among men dropped from 16.11% to 0. "For years I had been focused on the wrong currency," says Thompson. "I was always looking to see if people were here. I should have been looking at what they were getting done."

Today, Achen's commuting employee usually comes in once a week. Nearly three-quarters of his staff spend most of their time out of the office. Doesn't he worry that he loses some of the interoffice magic when they don't gather together all day, every day? What about the value in riffing on one another's ideas? What about teamwork and camaraderie? "You absolutely lose some of that," he says. "But what we get back far outweighs anything we've lost."

Achen says he would never go back. Orders processed by people who are not working in the office are up 13% to 18% over those who are. ROWE'ers are posting higher metrics for quality, too. Achen says he believes that's due to the new office paradox: Given the constant distractions, it sometimes feels impossible to get any work done at work.

Ressler and Thompson say all the Best Buy groups that have switched to the freer structure report similar results. Meanwhile, the two have other big plans for the company. Last month they launched a new pilot called Cube-Free. Ressler and Thompson believe offices encourage the wrong kinds of habits, keeping people wrapped up in a paper, prewireless mentality as opposed to pushing employees to use technology in the efficiency-enhancing way it was intended. Offices also waste space and time in an age when workers are becoming more and more place-neutral. "This also sets up Best Buy to be able to completely operate if disaster hits," says Thompson. Work groups that go cube-free will be able to redesign their spaces to better accommodate collaboration instead of working alone.

Next year Ressle and Thompson pla to pilot their bold est move yet, test ing ROWE in re tail stores amon both manager and workers. Ho exactly they will do this in an environ ment where salespeople presumabl need to put in regular hours, they won say. And they acknowledge it won't b easy. Still, they are eager to try ju about anything to help the compan slash its 65% turnover rates in store where disgruntlement is common an workers form groups on MySpace wit names like "Best Buy Losers Club!"

Best Buy has transformed its wor place culture in a remarkably sho time. Isn't it also true that ROWE cou unravel just as quickly? What happe if the company hits a speed bum Competition isn't getting any less i tense, after all. Best Buy sells a lot extended warranties, an area whe both Wal-Mart and Target are eag to undercut the electronics retailer price. What's more, the current boo in flat-panel, digital TVs will peak i few years.

If Best Buy's business goes south, human nature dicta that the people who always believed the clockless office w a flaky New Age idea will see an opportunity to try to fo a hasty retreat. Some at the company complain that prod tivity is up only because many Best Buyers are now worki longer hours. And some die-hard ROWE opponents still p vately roll their eyes when they see Ressler and Thomps in the hallway.

But it's worth remembering that most big companies to grow at the rate of inflation. That's true in part because bigger the company gets, the harder it is to get the best ou each and every employee. ROWE is one of Best Buy's answ to avoiding that fate. "The old way of managing and look at work isn't going to work anymore," says Ressler. "We w to revolutionize the way work gets done." Admit it, yo rooting for them, too. ■

The Untethered Workforce

How to kill meetings: For tips on how to do away with time-wasting corporate gatherings, go to www.businessweek.com/extras.

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NELSON "Why not change the IPO distribution business?"

NetSuite Gets Ready For Its Close-Up

After eight years, the Larry Ellison-backed startup looks set to go public

BY SARAH LACY

IT WAS LATE IN THE EVENING on Apr. 6, and a stressed-out Evan Goldberg was racing to get to Pier 38 on San Francisco Bay. Awaiting him there, he hoped, was a yachtful of co-workers and customers. But if his watch was right, they had set sail long ago. As Goldberg pulled up at the pier, a tanned young crew member took his keys and assured him that a speedboat was waiting to whisk him to the lavish offshore party. Goldberg relaxed and smiled. "Oh, yeah," he recalls thinking. "I'm in Larry's world."

In Silicon Valley, of course, "Larry" is Lawrence J. Ellison, the billionaire chief executive of Oracle Corp. The splendor of the evening, arranged for NetSuite Inc. clients and executives, attested to the fact that Ellison is also the proud majority owner of that growing, privately held software company run by Goldberg, its chairman and chief technology officer, and Zachary A. Nelson, its CEO. As Nelson, Goldberg, and a phalanx of their best salespeople gawked at the opulent *Ronin*, Ellison's "smaller" yacht, a few couldn't help but wonder when their own net worth would get a long-anticipated boost.

For years, NetSuite has been seen as the next great software stock offering. With 2006 revenues of about $70 million, NetSuite is eight years old—an octogenarian by Valley startup standards. Every six months, Nelson has ended his staffwide meetings with a slide on that IPO that always seemed to be just aro the corner.

Now, finally, NetSuite's stock offe may be at hand. After a whirlwind that included meeting with banker New York, Nelson and the rest of board on Nov. 20 entertained propo from a handful of investment bank San Mateo. At press time they were c to picking a team to pitch an offe in early 2007. The three institutions in the running, sources say, are Me Lynch, Credit Suisse First Boston, the smaller San Francisco firm Hambrecht & Co.

ORDINARY FOLKS

IT WOULD BE a rare tech IPO: Or tenth as many deals have been c pleted so far this year as in 1999. if structured as planned, as an auc open to the public, the deal would much smaller version of an epic V event, Google Inc.'s 2004 IPO. Ins of bankers peddling the shares to institutions and the very wealthy, e day folks would, in theory, be able t on to the Internet and bid alongsid institutions. Bankers would condu road show, run the auction, and exe orders. Says Nelson: "We're an Int company, and the whole thing is tha Internet changes everything. Why change the IPO distribution busines

A NetSuite IPO also would shi

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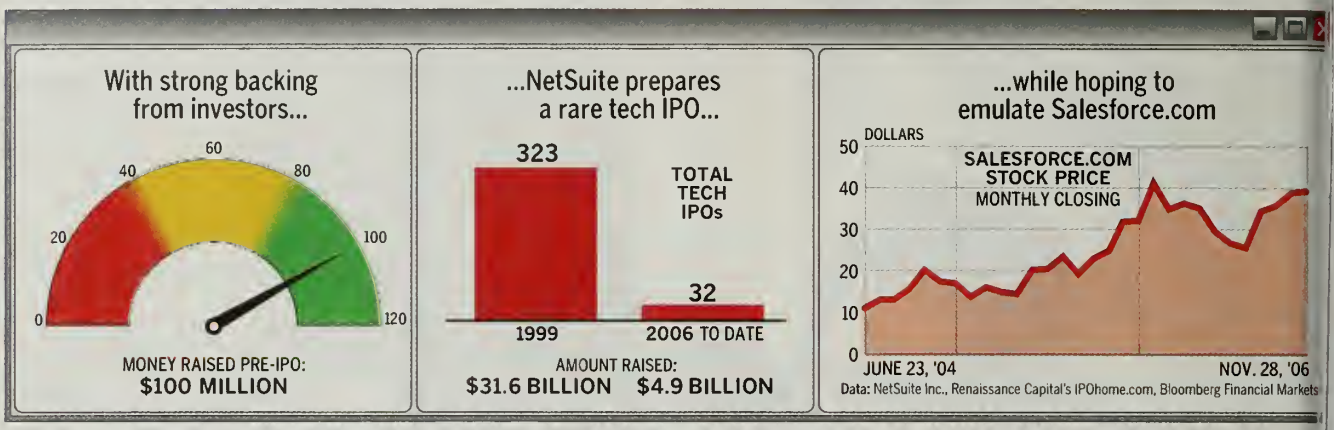

spotlight on Ellison's role in backing several software startups. He was an early supporter of Salesforce.com Inc., a software outfit that went public in 2004 and now has a $4.5 billion market cap. Its shares have risen 266%. Ellison has also invested the lion's share of the more than $100 million that NetSuite has raised to date. It could be argued that Ellison is profiting from growth opportunities that Oracle shareholders missed out on. Ellison wouldn't comment. But Steven B. Fink, CEO of Ellison's investment firm, Lawrence Investments, says that independent Oracle directors keep an eye on Ellison's investments and in the past they have raised questions "even if he's invested in a company that is upgrading to Oracle" software. He adds: "Since I'm not getting any calls from a concerned board member, it's a sign they're assuming [NetSuite's business] is just a different marketplace than Oracle's core business."

ELLISON Even after an IPO, he will probably retain majority ownership

Ellison and NetSuite's executives are talking about a deal that could raise another $100 million by selling just 10% of its shares. They hope to benefit from the strong showing of Salesforce.com and the lessons from Google's auction. Some bankers bad-mouthed that deal, viewing the process as a slap in the face because it dismissed their value as underwriters and cut them out of lucrative deal fees. But it's hard to argue with Google's success. As an analyst at one of the investment firms in the NetSuite mix told his bankers: "Larry's not stupid. They're doing it as an auction because they can. Just...get this deal."

People weren't always jumping to invest in NetSuite. If not for Ellison, it's likely the company wouldn't exist. In the late 1990s, two friends, Marc Benioff and Evan Goldberg, were mulling how the Web would change business software. Both had the idea to build tools to let salespeople organize their leads and contacts via a site as easy to use as Amazon.com. Benioff built just that after leaving Oracle, calling it Salesforce.com. But thanks to a five-minute conversation with Ellison, Goldberg—who had already left Oracle—took a different tack. Ellison told him to build easy, cheap software to manage small companies' accounting and financials, a considerably more complex undertaking. "That is the underpinning of [anyone's] business," Goldberg recalls Ellison saying.

From there the idea was to add programs that could organize warehouses, sales teams, online stores, you name it. Today, the software is aimed at businesses that are too big for Intuit Inc.'s QuickBooks but too small for offerings from Oracle or SAP. Instead of paying up front, customers fork over a monthly fee to have NetSuite run programs and beam them out over the Web. For time-strapped managers, NetSuite also pioneered easy-to-read desktop "dashboards" that give real-time readouts on metrics such as employee productivity or sales growth.

FIRED UP

ELLISON BELIEVED businesses wanted to purchase all their software from one company. Years later he would spend nearly $20 billion in a buying spree to make Oracle that company for large outfits. Done right, NetSuite could the same thing for small compani Fink says he has never seen Ellison engaged, so passionate about a compa other than Oracle. Ellison checks NetSuite dashboard daily to see how company is doing and checks in w Goldberg and Nelson regularly. And has never hesitated to write a check.

Why did the NetSuite offering t so long to jell? For one thing, it wa easy to get the business model ri There's a reason why very few la software companies sell to small bu nesses: They have to work just as har make a sale that is a magnitude sma To cut costs and turn what will be first profit this quarter, NetSuite t such steps as basing its support ce in the Philippines. Another factor in delay was that Ellison was in no rus sell. Nelson says that in his third yea the job, they were close to meeting bankers, but Ellison told him to l off. Instead he invested more mone double NetSuite's salesforce.

Even today the IPO is hardly a tainty. Ellison's heavy ownership off some venture investors early on, it could spook public investors as After the IPO he's still likely to own 50% of the stock. And while Google an important test case for a large pany going public by auction, the are hardly ironed out. In six pitch banks, not one described the off process the same way.

If the deal does come off, of co Nelson will have to please more s holders than just Ellison. And Net has a long way to go before it's th of Oracle or SAP. As Nelson says: looking forward to that moment in when we ring the [opening] bell. Th put on my coal [miner's] hat and gr lantern and go back into the mine."

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Where the Rubber Is the Roadside

Lindsay Smith makes sidewalks from old tires to help trees—and town budgets

BY STACY PERMAN

IT TOOK 26 TREES TO TRANSform Lindsay Smith from a screenwriter into an entrepreneur. One night in 2001, Smith noticed red Xs on ficus trees in her Gardena (Calif.) neighborhood. The next morning city workers were cutting those trees down because their roots were pushing through the sidewalk and causing it to buckle. Says Smith: "These were healthy, mature trees that were being destroyed." She persuaded Los Angeles County to give her 48 hours to find another solution.

In those two days she searched for sidewalk materials that might coexist with stately trees better than concrete. Her best lead came from Richard Valeriano, the senior public works inspector in Santa Monica. At his urging, U.S. Rubber Recycling Co. had made a prototype of sidewalk pavers from recycled tires. Smith got a hold of the prototype, showed it to county officials, and they left the remaining trees standing. U.S. Rubber wasn't interested in commercializing the prototype, but its CEO encouraged Smith to plow ahead. "I was raised in a house where inventing was a common thing," says Smith, adding that her grandfather came up with an insulated cup for Thermos.

Her own innovation was Rubbersidewalks Inc., a company that has installed footpaths made of recycled tires in 60 cities in the U.S. and Canada. Smith has also had requests from cities in Asia, Europe, Australia, and New Zealand. The premolded, prefabricated rubber squares are cut to fit and installed over a layer of crushed granite, with interlocking dowels connecting the sections. Individual pavers can be unlocked and removed for repairs. In 2006, Smith's 12-person company had more than $1 million in revenues, and next year she plans to move some of her production to New York to cut costs for East Coast customers.

SMITH In parts of Santa Monica, Rubbersidewalks replace cement

BUSINESSWEEK SmallBiz

Smith began development of her product with a $250,000 matching grant from the California Integrated Waste Management Board. Thanks to her excellent credit rating, Smith was able to "match" that sum with her credit cards. "I am not encouraging people to use that model, but without it I wouldn't have been able to use the grant," she says. She set about improving the prototype, making the rubber look more like concrete and making it more durable. Her biggest challenge was in hardening the prototype, so pedestrians wouldn't have to change their stride if some parts of a sidewalk were concrete and some were rubber. In 2004, an angel investor saw Rubbersidewalks featured on a TV show and offered the company $100,000 effectively launching Rubbersidewalks sales effort.

Many of Smith's customers face predicaments similar to that of Gordon Mann, the public works superintendent for Redwood City, Calif. His 2003 budget included $1 million just for pruning tree roots and repairing concrete walkways. The next year Mann started using Rubbersidewalks to replace sidewalks adjacent to trees. The rubber, he says, "looks similar to concrete and has been well accepted by the public."

While the Rubbersidewalks initially cost Mann's department about 50% more than concrete, they can save money in other ways. Mann says a typical root pruning in his city costs $150 to $300. And because the pavers can be installed closer to trees than concrete, Mann doesn't have to get easements, saving about $300 in legal fees per house. But his ultimate savings will depend on how long the Rubbersidewalks last. Says Mann: "If they only last five years, we may not have made the best choice." Smith says the pavers should last at least seven years.

FEWER LAWSUITS

SHE SEES OTHER benefits as well. The pavers reduce the number of lawsuits from people who trip or fall over broken concrete. They do not contribute to the so-called heat-island effect, which is the increase in urban air and surface temperatures caused by hot pavements, asphalt, and buildings. And, of course, they help save trees and reduce the amount of rubber in landfills.

For Smith, the move from screenwriting to entrepreneurship has been smoother than expected. At first, she says, "it was distressing because there was a conflict between being a creative person and being a businessperson. It was almost as if that was a betrayal." That feeling quickly passed. "Creating a product that didn't exist and persuading people that they need it is not different from inspiring people through writing," Smith explains. Plus, there are 14 trees in Gardena—and countless more in other towns—that wouldn't exist if not for her. ■

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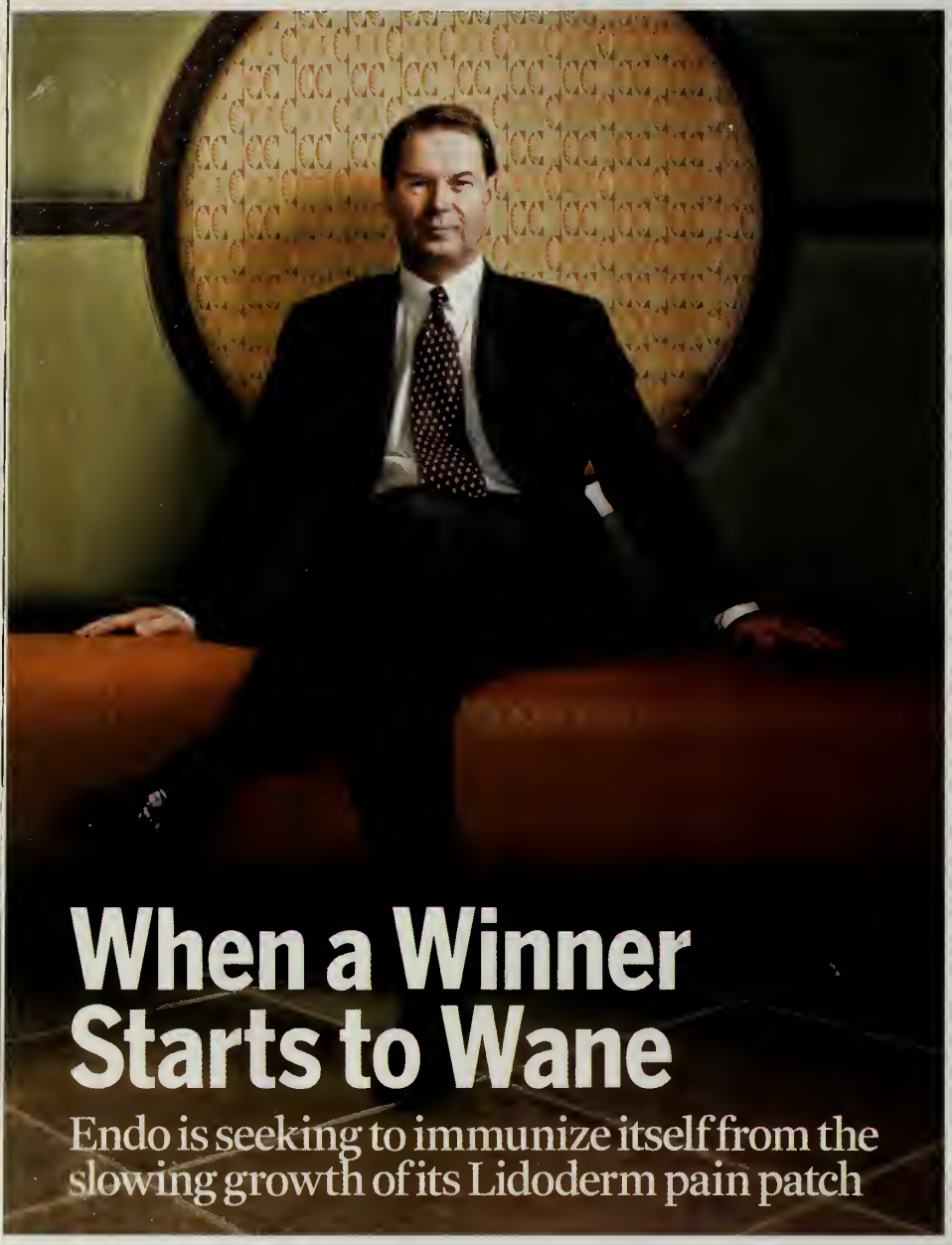

When a Winner Starts to Wane

Endo is seeking to immunize itself from the slowing growth of its Lidoderm pain patch

BY MICHAEL ARNDT

THE FOLKS AT ENDO PHARmaceuticals Holdings Inc. have a dependency problem. Nearly two-thirds of the company's revenues and three-quarters of its profits come from a single product, Lidoderm, a skin patch widely prescribed to relieve aches and pains.

That's not exactly dragging the drugmaker down. Lidoderm's sales are projected to reach $540 million this year, up 29% from 2005, or an additional $10 million in revenue for each month. Thanks mostly to the pain patch, Endo is No. 35 on *BusinessWeek*'s 2006 ranking of Hot Growth Companies, the only pharmaceutical company on the list.

But Endo may have to deal with its drug-dependency issue sooner than management had reckoned. Chief Executive Peter A. Lankau believes Lidoderm's patents will protect its monopoly through 2015. The Food & Drug Administration has signaled, however, that it may allow a patch that competes with Lidoderm to hit the market as early as 2009. "We are fully conscious of our need to diversify," Lankau says.

HOT GROWTH COMPANIES

Compounding Endo's problems, Lidoderm's growth rate is slowing, and there's no new magic pill on the horizon. Lankau contends that the company's latest drug Opana, an alternative to OxyContin, could be a hit. But the product is off to a disappointing start, and nothing else in Endo's drug development pipeline will be ready before 2008.

LANKAU
Gearing up to cope with Lidoderm knockoffs

Investors have gone from boastful to anxious. Endo's stock, which traded for less than 10 a share in 2003, touched 34.75 this past October. But the company has been downgraded by three brokerages in recent months, and the stock has tumbled to under 27, down 10% from a year ago. Analyst Gary Nachman of Leerink Swann & Co., who rates Endo as "market perform," or neutral, has also trimmed his revenue and earnings forecasts for 2006 and 2007. "I don't see anything coming up to get people over-excited," he says.

HEALTHY BALANCE SHEET

LANKAU, 53, SAYS the company is already adding to its product list to lessen the impact of a Lidoderm knockoff. For instance, Endo agreed to pay up to $115 million in mid-October to purchase RxKinetix Inc., which is developing a drug for mouth sores that cancer patients often get while undergoing radiation or chemotherapy. Endo is also pressing the FDA to reconsider its timetable for generic Lidoderm.

The mood at the company's Chadds Ford (Pa.) headquarters, near Philadelphia, is far from desperate. Endo is America's biggest pure play in pain medication today. It was spun off from DuPont in 1997 in a leveraged buyout led by the unit's president, Carol A. Ammon. She stayed on as CEO until May, 2000, when Lankau, a drug industry journeyman, took over. Endo went public in mid-2000 at 11.38 a share. Today, the company has a remarkable balance sheet for an early-stage drug company: $[illegible] million in cash and no long-term debt.

While Endo sells a half-dozen brand pain drugs such as Percocet and Percodan, plus a generic version of OxyContin, it was the launch of Lidoderm in 1999 that transformed the company. The product, an adhesive patch laced with a numbing agent called lidocaine, was approved for pain caused by shingles, a viral infection that affects some 750,000 adults in the U.S. a year. Almost immediately, doctors began prescribing it for all sorts of other ailments, from lower back pain to tennis elbow.

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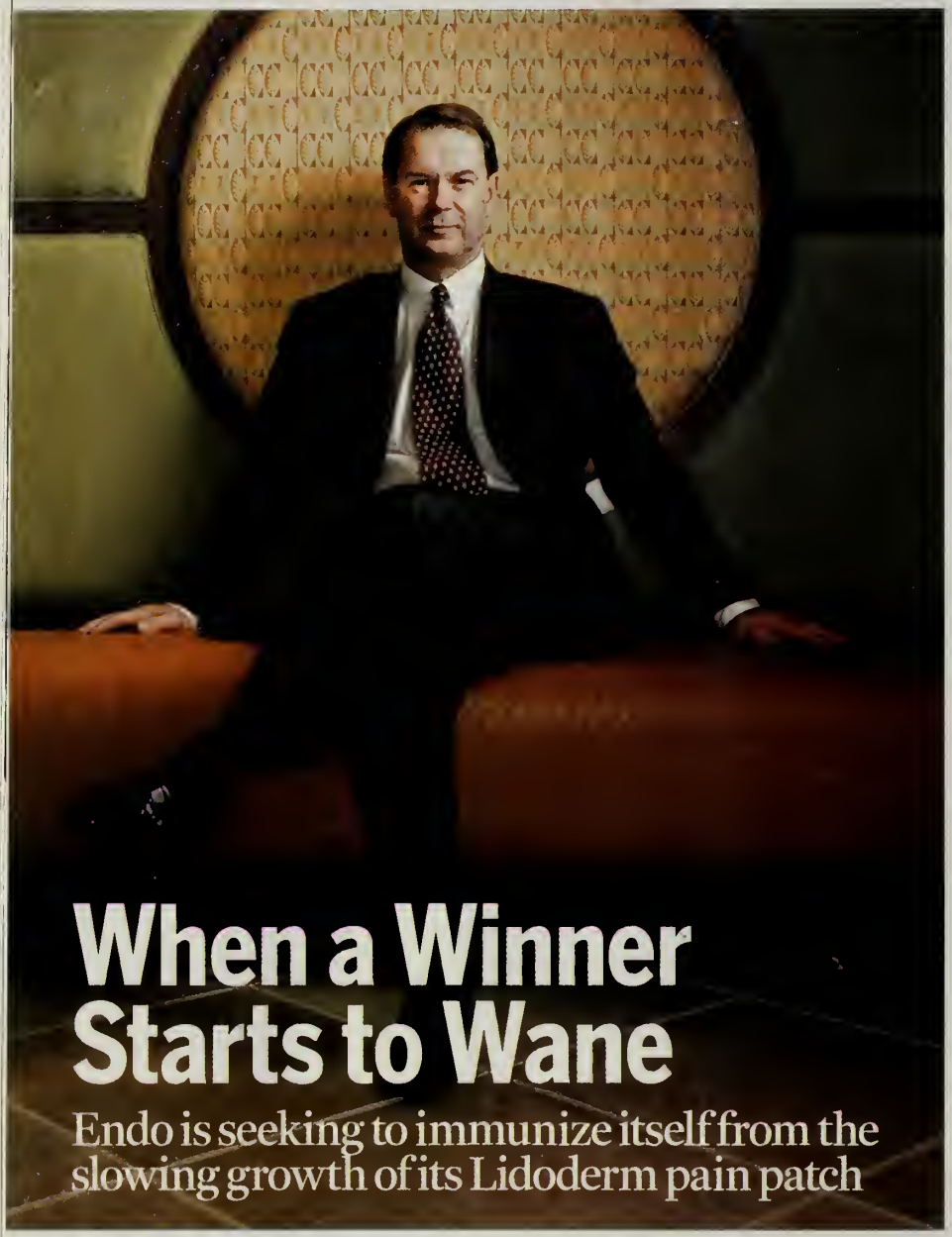

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SAP HAS AFFORDABLE SOLUTIONS FOR MIDSIZE COMPANIES?

plain old sore muscles. More than half of Lidoderm prescriptions are now for non-FDA-approved treatments.

In some medical practices, the ratio is even more skewed. Dr. Louis D. Bojrab, a principal at Michigan Pain Specialists in Ann Arbor, figures that for every Lidoderm prescription he writes for shingles, he writes nine more for other conditions. Bojrab says he dispenses Lidoderm so liberally because it is safer than pain pills, since it doesn't enter the bloodstream. The patch also lasts up to 24 hours and can be used repeatedly without worries about abuse or addiction. "It's a unique product," he says. "We use it for a lot of purposes."

YOUR ACHING BACK

THIS WIDE-RANGING usage appears to be perfectly legal. Drug vendors cannot urge doctors to prescribe products for anything but treatments authorized by the FDA. But sales reps can give doctors materials showing effectiveness in other studies. For Lidoderm, that includes trials showing the patch is effective on backaches and pain associated with diabetes and osteoarthritis.

Such details are at the core of Endo's campaign to "build the medical story," as Lankau puts it. And it's working. In 2004, Lidoderm accounted for 50% of Endo's $615 million in revenues. Next year the patch will make up 64% of the $980 million total even as Lidoderm's sales growth slows to 15%, Nachman predicts.

Opana, approved last June, was supposed to reduce Endo's exposure to the patch. To help promote the new drug this past fall, Lankau added 220 people to its sales force, a 60% increase. Yet through the third quarter, the company booked no sales for Opana, and it is no longer making any predictions about the drug's sales through the end of the year.

Despite Opana's slow start, analyst Megan Murphy of Lazard Capital Markets believes it will bring $130 million in sales next year. The company is also counting on help from Frova, a pill for menstrual migraines that is expected to get broader FDA approval in mid-2007. And in 2008, Endo may get the green light for Rapinyl, a fast-dissolving pain pill for cancer patients.

Clearly, demand for pain medication is rising, and companies that come up with effective remedies will be in a sweet spot. But since brand-name products are where the real money is, Endo needs to hold on to Lidoderm as long as it can. ■

OFF-LABEL DRUGS

Kills Pain, Cures Rabies, And Grows Hair

The prescription drug market is one part Big Brother and one part Wild West. To get a product into pharmacies, drugmakers must supply every data point the Food & Drug Administration requests to demonstrate the medicine is safe and effective, a process that can take eight years or more. Once the agency has approved a drug for its specified treatment, though, doctors may prescribe it for any ailment, as long as there is reason to believe that the drug will do some good.

These so-called off-label uses can mean a ton of money to drug producers. For example, Lidoderm, the pain patch from Endo Pharmaceuticals Holdings Inc., is projected to generate $300 million in sales this year as a treatment for all kinds of aches and pains. But it was approved for just one thing: alleviating pain from shingles, which is caused by a virus related to chicken pox.

Drug companies often seek FDA approval only for narrow applications because it is easier to prove effectiveness for one illness than for a broad range of diseases. This was the case with Celebrex, Pfizer Inc.'s versatile painkiller, which initially was O.K.'ed for just arthritis pain.

Anti-psychotics are also widely presc off-label, as are drugs for cancer and heart disease. A 2006 study by Dr. Randall Stafford, a Stanford Universit medical professor, found that 21% of all prescriptions are for unapproved treatments. For cardiac medications, share is as high as 46%.

The FDA formally bars drug compa representatives from talking up off-lal treatments. But the fact is, doctors ar often open to testing an approved dru novel settings when their patients dor respond to any standard treatment. D reps encourage thi behavior by handin studies showing hc their drugs perform in various clinical trials when doctors request such data. They also give awa samples as a favor patients. Doctors a patients then pass stories of successf off-label treatment one another, boost demand for the medications.

Sometimes the reps cross the line the late 1990s, Wa Lambert Co. illega promoted off-labe uses of Neurontin, an anti-seizure dr epilepsy, hiring doctors to plug the pu at physician conferences in resort se Although these practices occurred b Pfizer acquired Warner-Lambert in 2 Pfizer paid a $240 million fine when acquired unit pleaded guilty to charg off-label marketing in 2004.

Cephalon Inc. is currently under investigation by the Connecticut attc general for off-label marketing of Act a narcotic lollipop approved for pain spikes that cancer patients suffer. Th company says its reps promote proc only for their labeled uses, and that i is cooperating with the Connecticut authorities. *–Michael*

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QC2 headphones (left). New QC3 headphones (right).

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FOR TRAVEL WORK HOME

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DESIGNED FOR SUCCESS

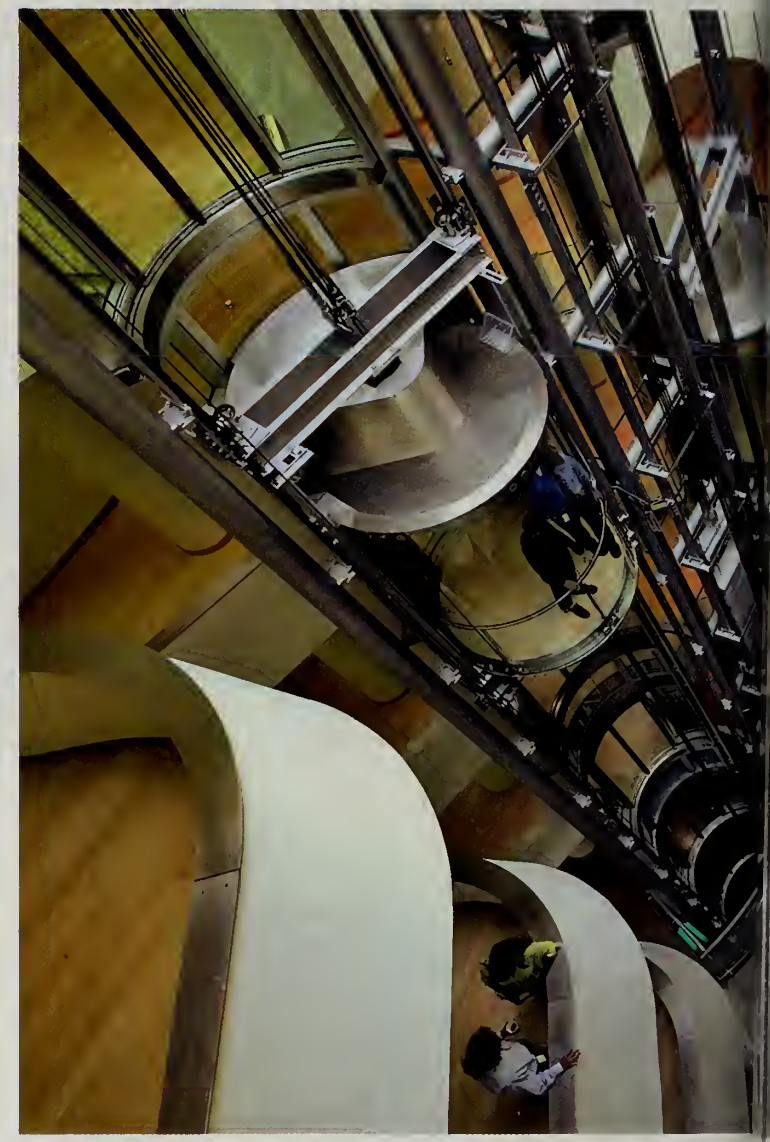
It takes more than just a pretty facade to win a *BusinessWeek/ Architectural Record* Award

THIS YEAR *BUSINESSWEEK* JOINS WITH *Architectural Record*, a sister publication at The McGraw-Hill Companies, to reward the world's most exceptional architecture. It's a contest that stretches beyond the aesthetic focus typical of most architectural awards programs. The *BW/AR* Awards program relies on rigorous metrics to measure how architecture solves client problems and achieves business goals. Winners of our ninth annual contest come from a competitive pool of 176 entries from across the world, showcasing the most successful collaborations between architects and clients. They vary in program, scale, budget, and size, but each combines business acumen with artistic excellence.

The eight winners represent great diversity. In one project, a 20th century candy factory finds a second life as a light-filled biomedical research lab. In another, a streamlined glass cube floods sunlight into subterranean retail space that has become a company's most successful outlet. A third project, for a Mexican ad agency, embodies flexibility by putting everything—including the walls—on wheels. What unites all of these projects is their clear demonstration of architecture's ability to be aesthetically compelling and bottom-line savvy at the same time.

–Jessi Hempel with John Gendall

BusinessWeek.com For slide shows of the eight winners and six finalists, go to www.businessweek.com/extras



» Bloomberg Headquarters
New York
Architects STUDIOS Architecture
Client Bloomberg

Bloomberg's business is selling information. In translating that communication to space, all 3,800 New York employees sit at open-plan workbenches. The architects doubled the number of conference rooms to make up for the loss of private space. All are enclosed by glass. STUDIOS used graphics throughout the floors that Bloomberg occupies in the 55-story building at 731 Lexington Ave. to relay information: market data, news, and reports on employee events. Large art objects bring the communal spaces to life.

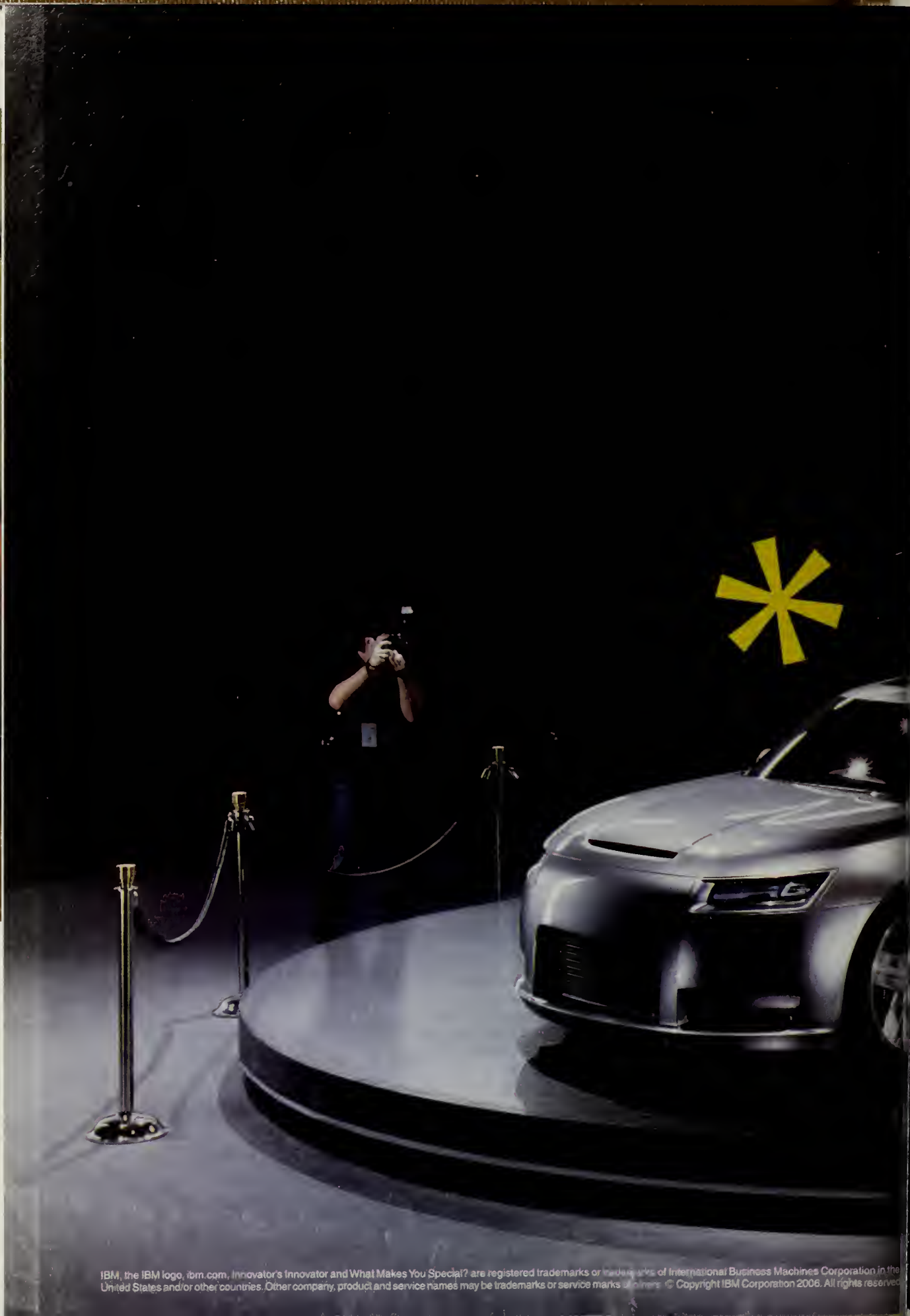
« Novartis Institutes for BioMedical Research
Cambridge, Mass.
Architects Stubbins Associates
Client Novartis Institutes for BioMedical Research

When Novartis decided to move its research headquarters to Cambridge, Mass., from Basel, Switzerland, the international pharmaceutical giant employed the Stubbins Associates to transform a Necco candy factory that was built in 1927 and is located near Massachusetts Institute of Technology into their high-tech research facility. The company believes that interaction and collaboration are vital to the science of drug discovery, so they wanted a space that would promote what company executives call the "sociology of science." To heighten openness, the architects created a single six-floor atrium. They removed walls wherever possible. When a partition was needed, they opted for glass to maintain a visual connection. A staircase snakes through the atrium, wrapping around the glass elevators that rise and fall within it. Says a jury member: "In an industry that competes heavily with its peers for talent, the building's design makes Novartis a very attractive place to work by bringing daylight deep into the offices and by making it open and interactive."

» Apple Store Fifth Avenue
New York
Architects Bohlin Cywinski Jackson
Client Apple Computer

Apple's highest-volume retail space is subterranean. A 32-foot cube takes up just 8% of the plaza in front of the 50-story General Motors Building, keeping that space open for public use. The structure relies on a system of taut glass skin, glass beams, and stainless steel fittings, appearing to float over the store below. The architects positioned the glass to spill sunlight in so shoppers never feel they're underground. A jury member calls it a "preeminent example of the power of architecture on business, and how the public understands and experiences a brand."

(CLOCKWISE FROM TOP) JEFF GOLDBERG; PETER AARON; ERIC LAIGNEL



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Nissan Design America
La Jolla, Calif., and
Farmington Hills, Mich.

Architects Luce et Studio Architects

Client Nissan Design America Inc.

In the supercompetitive automotive industry, designers need privacy. Luce et Studio created structures for both design and styling studios in California and Michigan that keep secrets safe yet feature the internal openness that will encourage designers to talk to one another.

TreuHandStelle at Nordstern
Gelsenkirchen, Germany

Architects Architect Team THS/PASD

Client TreuHandStelle

When THS needed a new headquarters, it renovated a decommissioned Ruhr Valley coal mine. The architect team THS/PASD cleaned the industrial waste, inserted ribbon windows, and restored the mining shafts and winding tower designated for preservation. The inactive mines still emitted methane, so architects added a system to drain this hazardous gas safely and use it as energy for the building's operation.

« Genzyme Center
Cambridge, Mass.

Architects Behnisch Architects and Behnisch Architekten

Client Genzyme

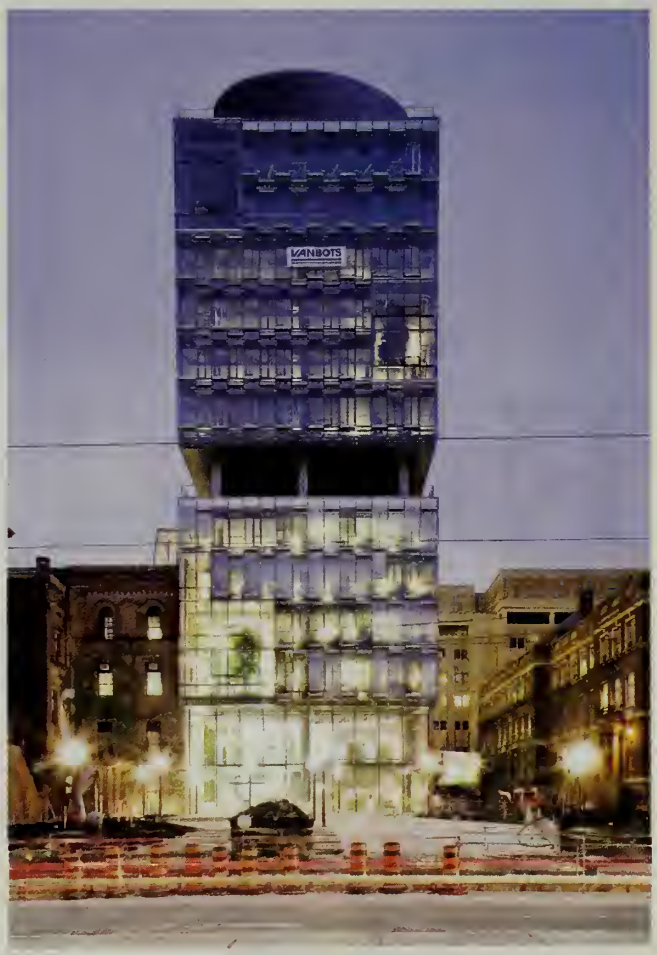
With a hanging chandelier sculpture inside a grand atrium, the Genzyme Center is as visually arresting as it is ecologically friendly. Among its features: a ventilated double skin that blocks heat gain and loss, a green roof, and natural light for 75% of the work spaces. The client estimates the building's operating costs are 42% less than a conventional office. "Daylight and a highly sophisticated use of sustainable design generates a rich collaborative environment," says a juror.

dea Factory Téran/TBWA
City

cts Garduño Arquitectos

Advertising Agency Téran/TBWA

TBWA asked Garduño Arquitectos for a at encouraged creativity and flexibility, vided the agency an identity within its company. The architects put everything ls—desks, cabinets, and even meeting The only static object is an axis of s that visually unifies all three floors.



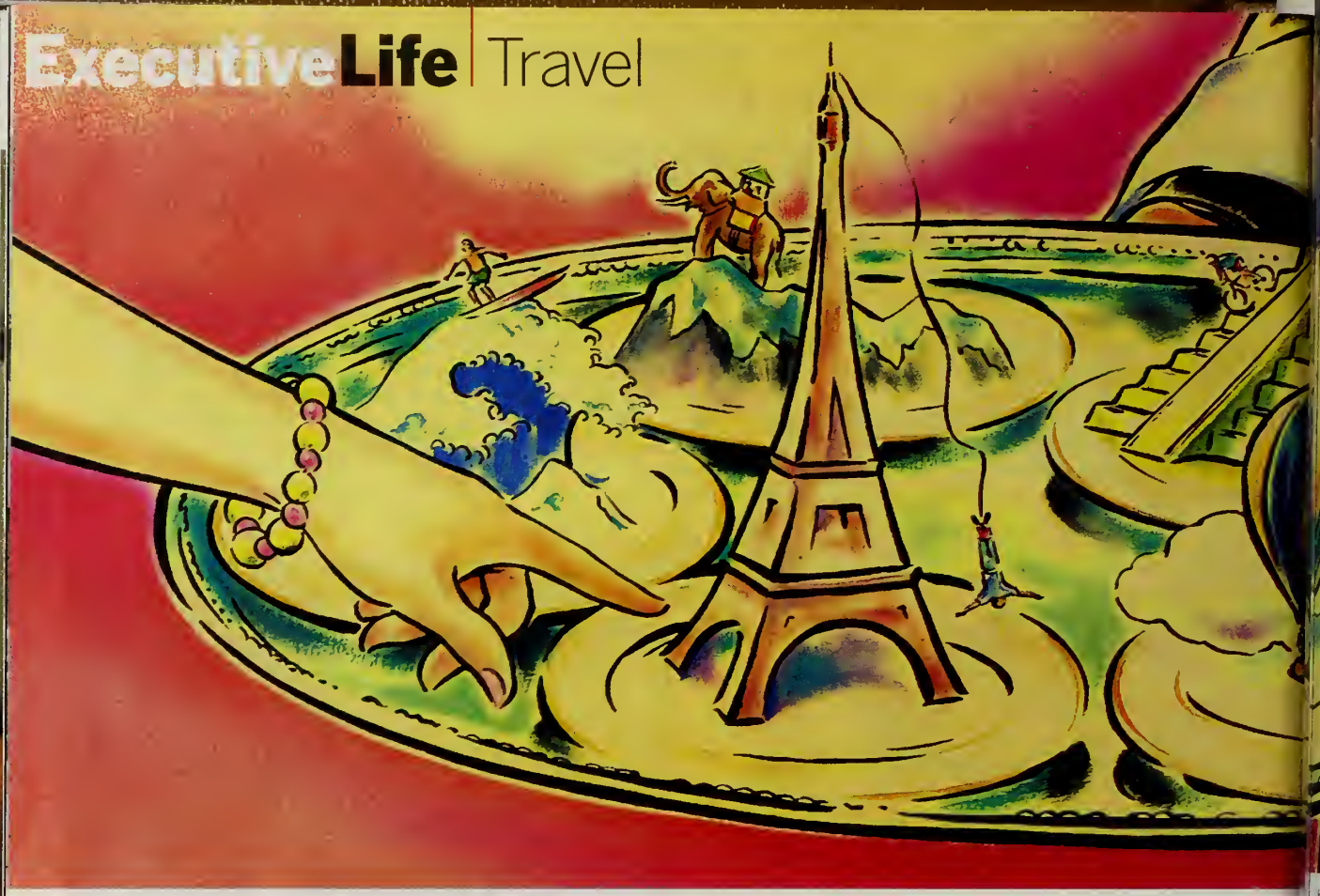
» Terrence Donnelly Center for Cellular & Biomolecular Research
Toronto, Ont.

Architects architectsAlliance and Behnisch Architekten

Client University of Toronto

Towering above the historic buildings of the University of Toronto campus, the building has the challenge of responding sensitively to the old-fashioned structures that surround it while meeting the demands of its occupants. A highlight is the naturally ventilated winter garden.

(CLOCKWISE FROM TOP) ANTON GRASSI; TOM ARBAN; LAURA COHEN; THOMAS MAYER; PAUL RIVERA



Finely Tailored Vacations

"Bespoke" travel agencies will design personalized trips to anywhere in the world, even on short notice. **BY AMY CORTESE**

IN THE HANCOCK HOUSEHOLD, it is a tradition that upon graduating from college each of the three children gets to choose a dream vacation to take with their parents anywhere in the world. But the second eldest, Trent, didn't allow much time for planning when he decided just three weeks before his graduation from the University of San Diego last May that he wanted to go to Peru. "I thought, 'We can't do that in three weeks!'" recalls Julie Hancock, who with her husband Mark owns a homebuilding company in Scottsdale, Ariz. ¶ Still, mom didn't want to disappoint, so she hopped online and found Blue Parallel, a boutique agency specializing in custom, or "bespoke," travel (blueparallel.com). Julie called and ticked off her wish list. The Incan ruins at Macchu Picchu, of course, were a must. Trent, an avid surfer, wanted to hang ten at Peru's fam beaches. Mark, who doesn't like rou ing it, insisted that only luxury acc modations would do. No problem. June 10, Julie, Mark, and Trent flew class to Lima for an 18-day adventur

Travelers like the Hancocks, who w out-of-the-ordinary experiences ofte short notice and are willing to pay them, are fueling the bespoke tr business. These trips are to travel v couture is to fashion: tailor-made, co and designed to make a lasting imp

"We have tax advisers, personal pers, and hairdressers" who provide nal service, why not travel agents, Tim Costigan, director of bespoke l for Butterfield & Robinson, a travel cy that focuses on biking and walk- ours (butterfield.com). Close to a of his agency's business now comes bespoke, vs. almost none ten years Abercrombie & Kent, another high- our operator, says 40% of its busi- is custom (abercrombiekent.com).

WITH A MAHARAJA

BIG AGENCIES have a vast world- network of offices and "destination ts" they can draw on. Smaller firms as Blue Parallel, which specializes tin America, and New York-based te Lands (remotelands.com), which es on Asia, rely on their intimate ledge of a region and the relation- they've developed there.

her way, these connections allow gents to offer experiences you don't ith packaged tours, whether dinner maharaja in India, a private perfor- e by local musicians, or a romantic r complete with fireworks in an ex- cale. There are more practical perks, cal cell phones, Internet access, and -track through customs. Catherine l, an entrepreneur who has lived and ed widely through Asia, founded Re- Lands after growing frustrated with other travel services she used. "They're supposed to be custom," she says, "but they give you the same cookie-cutter tour as everyone else."

Bespoke travel outfits typically start by quizzing clients about their interests and preferences, then craft itineraries that reflect them. Heald says her specialty is hooking clients up with locals, for example reindeer herders in Mongolia, Buddhist monks in Bhutan, or cannibals in New Guinea (they are said to eat only "witches" suspected of causing the death of a family member).

Emmanuel Burgio, a former New York investment banker who now lives in Argentina, says he started Blue Parallel with his old bosses in mind: people who are "short on time and want the best of the best." He often arranges super-luxe trips to World Heritage sites such as Macchu Picchu for busy professionals who might want to leave on Thursday evening and be back at their desks on Monday morning. His trips start at $1,000 per person per day, not including airfare.

Time was an issue for Alyssa and Roger Duncan of Ulysses, Kan. The engineer and accountant travel frequently and this year wanted to go to India. Since they only had a week of vacation to spare, Alyssa contacted Remote Lands early last month for a December trip. "I said I want to see the Taj Mahal and only have a week, so go for it," says Alyssa. In addition to stopping at tourist sites, the Duncans will squeeze in an elephant safari, dinner with a local royal family, a trip to Udaipur featuring a private, candlelight dinner on a pontoon boat on the lake, and a visit to a tribal ceremony in Rajasthan followed by tea in the home of one of the tribe member's families. "That's something you couldn't arrange on your own," says Alyssa, who pushed back the trip until spring for personal reasons.

A CHANGE OF PLANS

ANOTHER BENEFIT of custom travel is flexibility. The Hancocks had planned to spend a few days hiking in the Peruvian Amazon. But one day slogging through knee-deep mud proved to be enough. "One phone call and, boom, our flights were changed and we were on our way," says Julie.

Bespoke travel tends to be on the luxurious side, but most agencies are willing to accommodate a client's budget and party size. To save money, they might suggest forgoing the five-star hotel for a charming, under-the-radar place, or staying with a local family. John Beinecke, a New York investment manager, has booked trips for 20 or more family and friends, including a biking trip through Puglia last May, through Butterfield & Robinson.

For the Hancocks, the goal was to experience Peru to its fullest; price was not a big concern. Their trip included local guides and experiences: They saw a bullfight, shared a home-cooked lunch with a Peruvian family in their hacienda, and attended a private ceremony with a shaman in the valley beneath Macchu Picchu that, Julie says, "prepared us for the spiritual side of it."

Then there was the surfing. They went to two beaches in remote northern Peru where surfers can hitch mile-long rides on the waves. At Pacasmayo, the first beach, surfboards and wet suits were awaiting them, along with a surf guide (a local legend), and a photographer who captured the day's activities for them. "It was amazing," says Trent. "We really got lucky with waves and the people we met."

The Hancocks spent about $25,000, including first-class airfare. Julie, who usually makes the travel arrangements, believes it was well worth the price. "This is the first time I didn't have to do a thing," she says. Next year her son Chase is graduating. He's not sure where he wants to go yet, perhaps skiing in South America and then to Easter Island or the Galapagos. But one thing is already decided. The Hancocks will travel bespoke. ■

Mariska Hargitay's Life.

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Mariska Hargitay's Life on a BlackBerry Pearl.

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BY ROBERT PARKER

The Organic Essence of Provence

UNDER THE DYNAMIC LEADERSHIP of Christophe Delorme, Domaine de la Mordorée has come of age over the past decade. Delorme's family farms 135 acres spread throughout the Châteauneuf-du-Pape, Lirac, and Tavel appellations (the latter renowned for its delicious rosés). Mordorée produces multiple cuvées, and the following wines, all from vineyards tha are farmed either organically or biodynamically, represent the essence of Provence. They are about the purest wines one could possibly taste.

2004 Côtes du Rhône la Dame Rousse

90 points. This wine is a blend of 40% grenache, 30% syrah, 15% cinsault, and the rest carignan and counoise. Displaying terrific black cherry and blackberry fruit, licorice and spice box characteristics, good underlying crisp acidity, and medium body, this is a serious Côtes du Rhône to drink over the next three to four years. $13

2004 Lirac La Dame Rousse

90 points. No one makes a better Lirac than Mordorée, as evidenced by this offering. It boasts a dense ruby/purple color, gorgeous levels of opulent cherries, full body, and terrific concentration. This wine is a steal at the price and should drink well for four or five years. $19

2005 Tavel Rosé

90 points. Made primarily from grenache, this tank-fermented and seriously endowed rosé exhibits good acidity, loads of raspberry characteristics, surprisingly big body, and heady amounts of alcohol. It should be enjoyed with food. $19

2003 Lirac Cuvée de la Reine des Bois

93 points. Equivalent to many of the better Châteauneuf-du-Papes, this 2003 Lirac, a blend of equal parts grenache and syrah, reveals a dense purple color and a big, sweet nose of crème de cassis, blackberries, licorice, crushed rocks, and white flowers. Fabulous intensity, richness, and length all make for a remarkable wine to drink over th next five to eight years. $37

DELORME Family winemaker

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2003 Châteauneuf-du-Pape Cuvée de la Reine des Bois

96 points. This was a challenging vintage, but Mordorée's offering (70% grenache, 10% mourvèdre, and the rest equal parts cinsault, counoise, syrah, and vaccarese) is extraordinary. An inky ruby/purple color an a sweet nose of blackberries, camphor, licorice, spice box, and violets are followed a full-bodied, rich, layered beauty that sho drink well for 15 or more years. $117

2001 Châteauneuf-du-Pape Cuvée de la Reine des Bois

100 points. A blend of 78% grenache, 10% mourvèdre, and small quantities of cinsau counoise, syrah, and vaccarese, this wine boasts an inky/purple color as well as a he perfume of graphite, blackberries, kirsch, licorice, truffles, and charcoal. Full-bodied with endless concentration in its pure, der generous flavors, it has beautifully integra acidity, tannin, and alcohol. Made from 60-year-old vines and aged both in cask a foudres (extra large barrels) from what we obviously very low yields, this classic nee three to five years of cellaring. It will last for two decades and is an example of wha progressive winemaking can achieve with abandoning tradition. $295

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.com/e

lartin Eberhard's Life.

lartin Eberhard's Life on a BlackBerry Pearl.

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The Science Of Smart Giving

Squeezing the most good from large-scale donations takes serious planning. Here are five success stories. **BY JESSI HEMPEL**

HOW DO YOU GIVE AWAY $10 MILLION? You could start adding zeros to whatever checks you are writing to charitable institutions and worthy causes. But if you're going to hand over an eight-figure sum, you'll want more than a thank-you letter and a receipt to show the tax man. Such amounts "raise a question that isn't just material but emotional: How much impact am I going to have?" says Paul Schervish, director of Boston College's Center on Wealth & Philanthropy.

The tricky question for philanthropists is this: In an era of Buffett-sized billion-dollar gifts, when the number of donations that topped a million dollars has more than quadrupled to 2,197 last year from just 423 in 1985, how do you sift through the multitude of good causes to find the place where your contribution can really make a difference?

The key to success is focus, according to Rockefeller Philanthropy Advisor's Melissa Berman, who works with families to develop their philanthropic strategies. She urges families to start not with a particular charity, but with a conversation about values. Does it matter more, say, to support medical research or to embrace the arts? Once you've chosen a cause, search out the underdog. If, for example, everyone is giving to the American Diabetes Assn., you mi want to consider supporting a dia tes group that hasn't received mu funding. Then, work with advisers y trust—be they philanthropic consult firms, wealth managers, or friends a colleagues who have experience in p lanthropy—to find the best method put your funds to use. Giving strateg are as diverse as the causes that vie philanthropic support. Here are five amples of how families and individu have put their wealth to work.

INTERNATIONAL AID: Jim and Karen Ansara

Six years ago Jim and Karen Ans launched a $1.5 million charitable fo dation. "We would get enthusia about a program or a cause and ple a lot of money, and we wouldn't th about how we were leveraging organization," says Jim Ansara, owns Boston-based Shawmut Desig Construction.

So earlier this year, when he 70% of his company to his employ he and his wife took a much diffe approach to giving. Instead of dona through their foundation, they tu to the Boston Community Foundat where they started a donor-adv fund. The fund works like a fou tion: The Ansaras get a tax break they deposit funds into it, and oversee donations that are made f it. However, the community fou tion manages the administrative tails and helps the Ansaras ide the recipients. The Ansaras also m their foundation into the commu foundation.

The Ansaras already had a clear They wanted to help the impoveri women and children they had se their travels to Asia and Latin Am So far, they have made large gra support operations at just two int tional aid organizations: the dZi F dation, which provides ed tion, health, and we support to comm ties in the Himal and Oxfam Am Both 49, they to get their dren involved Jim brought 14-year-old s build latrine Nicaragua rec and Karen took 12-year-old dau to Ecuador.

DERN AND CONTEMPORARY ART: t and Vicki Logan

t and Vicki Logan began collecting n 1994 during a casual visit to a San cisco gallery, where they purchased inting by West Coast artist Mark k. Since then they've added 900 es to their collection. After Kent, 62, retired from investment bank- n 1999, the Logans moved to Vail, ., and built a private gallery next to home.

rlier this year, they bequeathed their ction, along with their house and

te gallery, to the Denver Art Mu- . They will also put $10 million in ndowment to fund the museum's rtment of modern and contempo- art. Why Denver? It isn't a center ntemporary art, but that's precisely the Logans chose it. "We could give the Museum of Modern Art in New , but it already has the definitive, l-class collection," says Kent Logan. enver, Logan saw a perfect opportu- In 1999, even as the local economy gled, the city sold municipal bonds lp erect a new building for the mu- . The Frederic C. Hamilton building ed in October, proof that Denver its collections seriously.

CATION: Coleman Fung

n Coleman Fung left Hong Kong ew York at 16, he had little money few worldly goods. He ed his way through l at the University lifornia at Berke- nd later founded are company Link. Though , 48, who lives ast Williston, has always charitable, this as his business he decided it was

time to scale up his philanthropy. Many funding advisers say that folks giving more than $10 million should look seriously at starting a family foundation over a donor-advised fund because their resources will allow them to set up a staff to operate the foundation, and they'll have more autonomy. In May he seeded a foundation with $18 million.

Fung focuses on education for poor kids. Already, he has funded several grants, including one to the Bronx Preparatory Charter School. He gave $75,000 to the operating fund and another $75,000 to send students to university summer programs. Says Fung: "I find niches where I know I can make a difference. If I can help one kid to turn his or her life around, that's a great return."

A private foundation has proved to be a lot of work. Fung, who is divorced and has children ages 15 and 12, spends about 5% of his time visiting potential grant recipients. Two friends help him with foundation responsibilities, and he relies on Foundation Source, a company that allows givers to outsource the administrative duties they might ordinarily hire staff to handle. But Fung isn't complaining. "As an immigrant, I don't take things for granted," he says. "Giving back is part of it."

REAL ESTATE: The Sobrato Family

Silicon Valley office space is some of the most expensive square footage in the world. But for 28 nonprofits, some of the fanciest Valley digs are free. They work out of a 110,000-square-foot Milpitas (Calif.) office park that real estate developer John and Sue Sobrato, both 67, and their three children donated to a community foundation in 2002. On Nov. 29, the Sobratos unveiled the finishing touch: a 4,000-square-foot conference center they built as part of the office park. A family foundation provides about $200,000 a year for maintenance of the facility.

The Sobratos give away buildings annually. Some, like the nonprofit center, are left intact. Others are then sold by a charity or a community foundation, and the funds are dispersed. It's a philanthropic strategy that's cash-efficient, says John Sobrato. "If you sell something to raise the cash, you have to pay capital-gains tax," he explains. But donate it first, and the charity or foundation gets the pretax value.

MEDICAL RESEARCH: Lee and Jane Seidman

When Lee Seidman began selling his network of Cleveland area car dealerships five years ago, he and his wife, Jane, decided to get serious about giving. So he called up the nonprofits that had depended on the Seidmans for small, reliable gifts and increased the contributions tenfold. Then he told each group, "Don't call me for another 10 years."

Instead, the Seidmans decided to make a gift that would make a substantial difference to the Cleveland area, where they had raised their six children. Lee, 74, had been treated for

pneumonia at the Cleveland Clinic as a young man, then later he had allergy tests and, at 35, underwent a routine operation. His wife has been a patient there as well. In May they made a $17 million pledge to establish the Jane H. and Lee G. Seidman Chair in Functional Neurosurgery. The pledge will also create a fund to support new brain-related technology.

After paying the education expenses of their nine grandchildren, the Seidmans hope to give away the remainder of their wealth. "We don't want to leave millions of dollars in our estate to be taxed," says Lee. "And I am having a lot of fun." ■

A New Way to Beat the Market?

So-called 120/20 funds use leverage and short sales to boost bullish bets. **BY ANNE TERGESEN**

TO BEAT THE MARKET, mutual fund managers often ramp up risk, making outsize bets on stocks they expect to outperform. Now some quant jocks say they've hit upon a less risky approach: A strategy called 120/20, which, ironically, combines two risky strategies, leverage and short sales.

Until recently, this strategy was available mainly to institutional investors. But this year, companies such as Goldman Sachs, ING, and Merrill Lynch have incorporated it into mutual funds and separately managed accounts. Some $36 billion is in 120/20-type programs, up from virtually nothing three years ago, says Harindra de Silva, president of Analytic Investors, a Los Angeles money manager that offers three such mutual funds.

The goal is to beat a benchmark, such as the Standard & Poor's 500-stock index, by as much as three percentage points a year after fees, says de Silva. Even a single percentage point can make a big difference. For example, in the 10 years ending Sept. 30, the S&P 500 earned a compounded average annual growth rate of 8.57%, so a $10,000 investment grew to $22,756. Add a percentage point per year and the total comes to $24,941, or nearly 10% more. "In a low-return environment, this type of enhancement is compelling," de Silva says.

It's too soon to know if 120/20 funds can deliver since few have much of a track record. De Silva's Old Mutual Analytic U.S. Long/Short, which adopted the strategy in February, had beaten the S&P 500 by 1.6 percentage points by Nov. 24.

SHORT STUFF

HERE'S HOW IT WORKS: For every $100 the manager invests in stocks, he sells "short" $20 worth of stocks on which he is bearish, making a bet these stocks will fall. The manager then invests the p ceeds from the short sales in his bull picks, amplifying those bets. As a res a 120/20 portfolio has about 100% of money in the market. (Some manag build 130/30 or 135/35 portfolios, pu ing short sales to 30% or 35%.)

Money managers say the strategy enhance returns for two reasons. F they can make money not just on sto they like but also those they don't l Second, they can put even more mo to work in their top picks. That impro payoffs, provided the picks are on tar

Backers say these portfolios, if structured properly, expose investors to a bit more risk than they'd get witl index fund. The reason: While they magnify their bets, they're also hed For example, a manager with a heav location in Target might short shares rival, say, Wal-Mart. The assumptio Target falls, Wal-Mart will fall furthe that case, profits on the short positic Wal-Mart would help offset losses on get. The risk, of course, is that the ma er is wrong, and Target falls as Wal- rallies. Interested? Watch how the f perform. Until they prove themselves Todd Trubey, an analyst at Mornin "there's no reason to jump in." ■

Curbing Risk With Risky **Plays**

The combination of short sales and leverage give these funds a built-in hedge. It's too soon to know whether they can deliver.

FUND/SYMBOL
Goldman Sachs Structured Intl. Equity Flex Fund (GAFLX)
Goldman Sachs Structured U.S. Equity Flex Fund (GFEAX)
ING 130/30 Fundamental Research (IOTAX)
Old Mutual Analytic Defensive Equity (ANDEX)*
Old Mutual Analytic Global Defensive Equity (ANGAX)*
Old Mutual Analytic U.S. Long/Short (OADEX)
UBS U.S. Equity Alpha (BEAAX)

*These funds may also use options

Data: *BusinessWeek*

ACING AN UPHILL BATTLE WITH PENDING LITIGATION?
ET THE POWER OF DUFF & PHELPS.

om dispute consulting and complex valuation alysis to forensic investigation and expert testimony, uff & Phelps provides trusted analysis and insight critical issues. With more than 700 professionals orking together across North America, Europe d Asia, we have the depth and breadth of dustry and technical expertise to meet your needs. t the strength of one of the world's leading dependent financial advisory firms.

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BY GENE G. MARCIAL

SIZZLING CABLE GROWTH ABROAD BOOSTS LIBERTY GLOBAL.

DUKE ENERGY IS HIVING OFF ITS NATURAL GAS OPERATIONS.

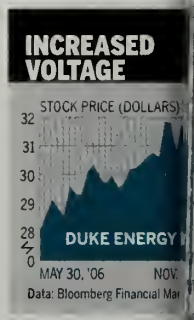
WATCH FOR GOOD NEWS SOON FROM ALLOS THERAPEUTICS.

Liberty Rings the Bell

SINCE MARCH, LIBERTY GLOBAL (LBTYA) has shot from 18 to 27.36, propelled by booming business overseas. Cable giant Liberty, of which John Malone owns 27%, offers video, voice, and Internet services to 13 million customers in 17 countries, mainly in Europe—plus Australia, Chile, and Japan. Liberty is a good avenue to the growing demand for the "triple-play services," says John Maloney, president of M&R Capital Management, which has bought shares. At 7.9 times estimated 2007 earnings before interest, taxes, depreciation, and amortization, with a 17% yearly growth rate, Liberty is cheaper than Comcast, which trades at 10 times earnings and is growing at 15%, says Maloney. He thinks the stock will be at 58 in two years. Third-quarter results beat analysts' forecasts, with revenues jumping 47%, to $1.62 billion, and operating cash flow rising 50%, to $599 million. Given the robust results, Jeff Wlodarczak of Wachovia Capital Markets raised his 2007 revenue estimate to $7.5 billion and operating cash flow to $2.8 billion, up from the $6.4 billion and $2.3 billion expected in 2006. Liberty should be in the black by 2008, says Wlodarczak, with earnings of $35 million, or 8¢ a share, jumping to $158 million, or 36¢, in 2009. On Nov. 28, Liberty said it was offering to buy back as much as $300 million of its A and C shares at 26 to 29.50, on top of the $1 billion worth repurchased in September.

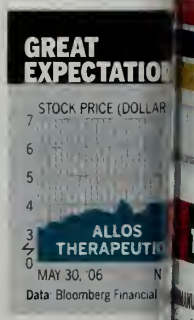
Why a Spin-Off May Spark Duke Energy

AS DUKE ENERGY (DUK) prepares to spin off its natural gas business in January, investors are starting to see its stock as an unusually attractive energy play. The move could unlock Duke's value as an electric utility. Shares have climbed from 27 in May to 31.68 on Nov. 29. Its gas operations will be spun off into a separate public entity, 100% owned by Duke shareholders. They will receive new shares of the gas transmission business. The "narrowed management focus, more efficient use of capital, and removal of what appears to be a conglomerate discount on Duke's price will fuel expansion [for both companies]," says Daniel Ford of Lehman Brothers, which was the adviser on the spin-off. He says investment opportunities and strong balance sheets at both Duke Energy and the gas company "should provide steady earnings growth through the end of the decade." CEO James Rogers will add the title of chairman after the spin-off. Ford says that, on a sum-of-the-parts basis, Duke is worth 21 a share, and the gas spin-off 14. Shelby Tucker of Bank of America, which owns shares, says the move creates near- and long-term value for shareholders. He tags Duke Energy a "buy."



Two Allos Drugs Are Taking Aim at Cancer

ALLOS THERAPEUTICS (ALTH) is the next biotech to watch. So argue some analysts, who expect Allos, which is developing anti-cancer drugs, to present "positive results" from two major products at a meeting in early December. Allos' lead compound, Efaproxyn, now in Phase III clinical trials, seeks to enhance radiation therapy brain cancer. The other product, called PDX, is being testec in patients with peripheral T-cell lymphoma. Mark Monane of Needham, which has done banking for Allos, says what the biotech plans to reveal at the American Society of Hematology meeting "will fire up investor interest." He expects "encouraging" data on both drugs. Allos' stock has jumped from 3.80 on Nov. 3 to 5.74. Monane rates it a "strong buy," with a 12-month target of 9. He says a published study in the *British Journal of Cancer* on June 13 examined the effect of Efaproxyn in patients with brain cancer and found a "correlation betwe improved survival and response rate in those who receive higher exposures [to the drug]." Rahul Jasuja of MDB Cap Group, who rates Allos a "buy," says these products provi "two shots at the goal."



BusinessWeek.com Gene Marcial's Inside Wall Street is posted at businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor firms hold positions in the stocks under discussion. Similarly, they have no invest banking or other financial relationships with them.

TOCKS

MMENTARY

ıer oil prices and an upward sion to third-quarter nomic growth helped the 500 reclaim some lost nd after a falling dollar and November results from Mart leveled equities earlier e week. The S&P oil index hit cord as crude prices climbed two-month high. An analyst ngrade helped push Tellabs ı 10.4% on the week.

Bloomberg Financial Markets, Reuters

U.S. MARKETS

	NOV. 29	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1399.5	-0.5	12.1	11.3
Dow Jones Industrials	12,226.7	-0.8	14.1	12.3
NASDAQ Composite	2432.2	-1.4	10.3	8.9
S&P MidCap 400	807.1	-0.6	9.4	10.0
S&P SmallCap 600	399.4	-0.8	13.9	13.2
DJ Wilshire 5000	14,049.7	-0.5	12.4	11.9

SECTORS

BusinessWeek 50*	793.7	-0.4	7.0	5.5
BW Info Tech 100**	440.8	-1.3	15.9	15.2
S&P/Citigroup Growth	650.4	-0.5	9.0	8.2
S&P/Citigroup Value	746.8	-0.4	15.3	14.5
S&P Energy	460.6	4.0	23.6	24.3
S&P Financials	478.7	-1.3	12.3	10.8
S&P REIT	201.1	-0.3	31.4	29.2
S&P Transportation	271.2	-1.9	8.5	9.4
S&P Utilities	184.4	1.1	15.5	15.3
GSTI Internet	201.6	-1.8	-1.8	-2.1
PSE Technology	880.4	-2.0	5.3	5.1

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	NOV. 29	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1924.6	-0.2	27.3	32.1
London (FT-SE 100)	6084.4	-1.2	8.3	10.8
Paris (CAC 40)	5381.3	-1.3	14.1	17.3
Frankfurt (DAX)	6363.8	-1.7	17.7	22.4
Tokyo (NIKKEI 225)	16,076.2	1.0	-0.2	7.7
Hong Kong (Hang Seng)	18,780.9	-2.4	26.2	25.0
Toronto (S&P/TSX Composite)	12,668.2	0.9	12.4	15.8
Mexico City (IPC)	24,776.1	0.4	39.2	48.4

FUNDAMENTALS

	NOV. 28	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.79%	1.76%	1.81
S&P 500 P/E Ratio (Trailing 12 mos.)	17.6	17.6	18.4
S&P 500 P/E Ratio (Next 12 mos.)*	15.0	15.2	15.1
First Call Earnings Revision*	-0.65%	-1.51%	-1.99

*First Call Corp.

TECHNICAL INDICATORS

	NOV. 28	WEEK AGO	YEAR AGO
S&P 500 200-day average	1304.1	1302.3	Positive
Stocks above 200-day average	69.0%	72.0%	Neutral
Options: Put/call ratio	0.91	0.75	Positive
Insiders: Vickers NYSE Sell/buy ratio	5.55	5.46	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	15.5	Steel	89.6
Tires & Rubber	14.0	Divsfd. Metals & Mining	61.3
Office REIT's	13.1	Department Stores	43.1
Spclzd. Cnsmr. Serv.	11.7	Agricultural Products	42.2
Motorcycles	10.1	Motorcycles	34.8

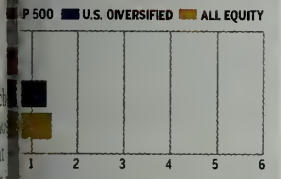
WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Agricultural Products	-12.4	Education Services	-47.5
Health-Care Supplies	-8.4	Homebuilding	-24.8
Automobiles	-7.9	Internet Software	-18.3
Drug Chains	-6.3	Health-Care Supplies	-15.5
Hypermkts. & Suprcntrs.	-6.2	Internet Retailers	-13.1

UTUAL FUNDS

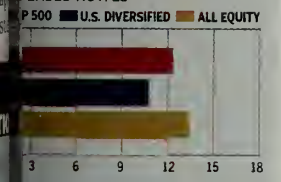
EEK TOTAL RETURN

ENDED NOV. 28



VEEK TOTAL RETURN

ENDED NOV. 28



tandard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Precious Metals	6.0	Precious Metals	42.8
Pacific/Asia ex-Japan	5.4	Pacific/Asia ex-Japan	34.9
Diversified Emerging Mkts.	4.1	Latin America	34.3
Natural Resources	3.9	Europe	31.6
LAGGARDS		LAGGARDS	
Japan	-3.0	Japan	2.7
Health	-0.9	Health	5.1
Financial	0.4	Large-cap Growth	5.6
Large-cap Value	0.8	Technology	7.4

EQUITY FUNDS

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
iShares Silver Trust	11.2	Oberweis China Opport.	76.7
OCM Gold	9.1	U.S. Glbl. Invs. Prc. Mnls.	67.4
DireXn. Cmdty. Bull 2X	8.9	U.S. Global Invrs. Gold	65.9
Dreyfus Prem. Grtr. China A	8.5	Dreyfus Prem. Grtr. China A	64.2
LAGGARDS		LAGGARDS	
BlackRock Euro Inv. A	-8.7	Ameritor Investment	-87.5
ProFunds UltSh. Emrg. Mkts.	-7.4	DireXn. Emrg. Mkts. Short	-49.6
DireXn. Emrg. Mkts. Short	-6.8	DireXn. Sm. Cap Bear 2.5X	-28.6
DireXn. NASDAQ 100 Bear 2.5X	-6.5	American Heritage Grth.	-25.0

INTEREST RATES

KEY RATES

	NOV. 29	WEEK AGO	YEAR AGO
Money Market Funds	4.86%	4.85%	3.59
90-Day Treasury Bills	5.04	5.06	3.98
2-Year Treasury Notes	4.68	4.75	4.39
10-Year Treasury Notes	4.52	4.57	4.48
30-Year Treasury Bonds	4.61	4.65	4.69
30-Year Fixed Mortgage †	5.95	6.00	6.20

† BanxQuote Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.69%	4.10%
Taxable Equivalent	5.27	5.86
Insured Revenue Bonds	3.79	4.33
Taxable Equivalent	5.41	6.19

THE WEEK AHEAD

ANUFACTURING INDEX *ay, Dec. 5, 10 a.m. EST* »The ute for Supply Management's anufacturing activity index vember is forecast to yield pretty steady at 57%. the median forecast of mists polled by Action mics. The October index nded to 57.1%, although ndents, most of whom e in service industries, ed a slowdown in orders.

FACTORY INVENTORIES *Tuesday, Dec. 5, 10 a.m. EST* »Manufacturing inventories probably rose 0.8% in October, after a second straight monthly gain of 0.6% in September.

INSTALLMENT CREDIT *Thursday, Dec. 7, 3 p.m. EST* »In October consumers probably piled up a further $4.4 billion of debt, following a decline of $1.2 billion in September. The drop was due to the biggest monthly decline in nonrevolving credit, which is made up largely of auto loans, in 15 years.

EMPLOYMENT *Friday, Dec. 8, 10 a.m., EST* »Nonfarm payrolls in November are expected to have risen by 125,000 workers, after an October gain of 92,000 jobs. The jobless rate probably remained at a svelte 4.4%. Average hourly earnings most likely rose by 0.3% while the average workweek probably held at 33.9 hours.

The *BusinessWeek* production index edged up to 283.8 for the week ended Nov. 18, an 8.2% gain from a year ago. Before calculation of the four-week moving average, the index climbed to 284.7.

BusinessWeek.com

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

OUTSOURCING

LESSONS FROM THE FRONT LINES

LEADING OUTSOURCING PROVIDERS AND CLIENTS COME TOGETHER IN A VIRTUAL ROUND TABLE TO DISCUSS SOME OF THE LESSONS LEARNED IN THE LAST YEAR

DAVID SMITH: We outsource about 95% of our operations. Our basic approach is that we do what we can do best or we contract the best. Our engagement with Perot Systems is not a contract-driven relationship. It truly is a partnership.

MIKE KERREY: With Old Mutual, we really focused on the knowledge and process transfer. There's no magic: it takes a lot of good processes, knowledgeable people, and a partnership where you can continually set the end goal. As you achieve each goal, you shift to the next.

GEORGE MURPHY: Like most HR departments, we began outsourcing through the benefits area. Then we progressively looked at additional areas where we could standardize an offering and remove some of the administrative detail from the work.

MARK TOON: How should companies transition from internally provided services to outsourcing?

MURPHY: The transition should begin even before you start outsourcing. You must carefully map all your processes and identify key time lines and events in advance so that you hit your date. That also will give you a flavor of how you're going to work together once you hit implementation.

TOON: How do you create alignment between the outsourcing service provider and the client?

SMITH: We set the expectation that the outsourcer is going to manage all the processes and we will govern them. I have day-to-day managers who manage the service levels and the dashboards that we receive on a daily, weekly, and monthly basis. We review the metrics in a monthly teleconference.

KERREY: It can be as simple as pricing structure. In some cases, for example, our clients pay a per-unit fee based on the work we do. If we make them successful, we end up "worth" more units. And the better our service, the faster their business grows.

TOON: How do you measure success?

SMITH: Success is based on service delivery, particularly factors like quality, timeliness, and flexibility. It was also key for us to have better pricing. All those things have been a tremendous success. Yet I've never been in a position where you can rest comfortably. There's always something new to focus on.

TOON: Governance, the process of managing the relationship on both sides, is not always handled well by clients. What kind of governance issues do you wish clients would improve?

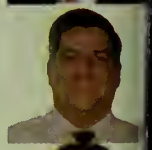
KERREY: Becoming more involved from a strategic standpoint moves us from a reactionary mode to a true partnership. For example, with Old Mutual, we sit on a number of its internal committees. Since we're part of the planning process, we can shape the future together, instead of hearing about something after the fact.

MURPHY: If the only time you're showing up at your outsourcer is when you've got a problem, you create the wrong environment all the way around. It's best to have a process in which you discuss what's going right, proactively work through that, and get the governance model set up right at the front end.

SMITH: The bottom line is that, in order for us to be successful, the outsourcer has to be successful. We do everything in our power to make sure that happens.

PARTICIPANTS

MARK TOON
CEO, EquaTerra (moderator)



DAVID SMITH
senior vice president, operations
Old Mutual Financial Network

MIKE KERREY
BPS leader, insurance practice
Perot Systems

GEORGE MURPHY
executive director, compensation and benefits
AstraZeneca

WEB DIRECTORY

AstraZeneca
www.astrazeneca.com

EquaTerra Inc.
www.equaterra.com

Old Mutual Financial Netw
www.omfn.com

Perot Systems Corp.
www.perotsystems.com

To access the entire round-table discussion and learn more outsourcing best practices, go to **www.equaterra.com**.

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TRUST.

t Perot Systems, earning client trust is not just a goal, it's a of life. More than 20,000 associates stand ready to lift organization to new heights with an extensive portfolio of ulting, applications, business process, and IT infrastructure ions. We serve more than 400 clients in the healthcare, rnment, and commercial sectors.

e's an example of one insurance client's results–

trusting their life insurance and annuity business support ctions to Perot Systems, **Old Mutual Financial Network** ww.omfn.com), a leading national financial services company, hieved many critical business objectives:

- » Reduced end-to-end cycle time for fully underwritten policies from 22 to 18 days.
- » Reduced information technology and insurance transaction costs by more than 20%.
- » Accelerated and enabled aggressive product and market expansion.
- » Decreased process cycle times for 1035 exchange/transfer annuities to an average of less than 25 calendar days.
- » Realized millions of dollars in annual savings.

n you need a hand to reach your goals, we'll be there.

For success tips on building greater trust in business relationships, review *Avoiding the Seven Deadly Sins of Outsourcing,* a White Paper by James Champy - a business process thought leader and transformation expert. Read or download at:

www.perotsystems.com/thoughtleadership

2006 Perot Systems

It's about money.
Earning it.
Investing it.
Spending it.

Check out this weekend's show December 2 and 3:

Clock-Free Office: Meet happy workers at Best Buy's HQ, who work wherever and whenever they want and get the job done.

Hot Holiday Toys: Check out the season's most sought-after toys to see which get the best ratings from the real experts — kids.

College Loans: As the grace period ends for millions of students' college loans, it's time to consider repayment options.

Smarter Suitcases: Innovative luggage features address travelers' frustrations and make for smoother travel.

BusinessWeek weekend

Airs Saturday/Sunday nationwide. Find your local station and airtime by zip code at **businessweekweekend.com**

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A
Abercrombie & Kent **90**
Affiliated Computer Services (ACS) **34**
A.G. Edwards (AGE) **42**
Air France-KLM (AFK) **34**
Alitalia **34**
Allied Artists **71**
Allos Therapeutics (ALTH) **100**
Amazon (AMZN) **72**
American Home Mortgage (AHM) **42**
America's Research **34**
Analytic Investors **98**
Apple (AAPL) **84**
architectsAlliance **84**
AT&T (T) **60**
Atieh Bihar Consulting **48**

B
Bank of America (BAC) **100**
Behnisch Architekten **84**
Berkshire Hathaway (BRK) **40**
Best Buy (BBY) **60**
Bharti Enterprises **34**
Bloomberg **84**
Blue Parallel **90**
Bohlin Cywinski Jackson **84**
Boston Consulting **60**
BP (BP) **18, 48**
Break.com **28**
Butterfield & Robinson **90**

C
Caribou Coffee (CBOU) **60**
Casesa Shapiro **36**
Catalyst **14**
CBS (CBS) **28**
Cephalon (CEPH) **82**
Cerberus Capital **42**
China Netcom **52**
Christie's **14**
Citigroup (C) **14, 40**
CNOOC (CEO) **52**
Coach (COH) **14, 34**
Comcast (CMCSA) **100**
comScore Networks **34**
Countrywide (CFC) **42**
Credit Suisse **72**

D
Daewoo **36**
Dell (DELL) **52**
Deloitte & Touche **64**
Delta (DALR) **34**
Deutsch LA **38**
Domaine de la Mordorée **94**
Duke Energy (DUK) **100**
DuPont (DD) **78**

E
eBay (EBAY) **71**
Endo (ENDP) **78, 82**
ENI (ENI) **48**
ExxonMobil (XOM) **48**

F
Fannie Mae (FNM) **14**
First Franklin **42**
Fortress Investment **13**
Fox (NWS) **28**
Freeman **13**

G
Gallup **60**
Garduno **84**
GE (GE) **60**
General Atlantic Partners **52**
Genzyme (GENZ) **84**
Gerber **34**
GM (GM) **36, 38, 42**
Golden West **42**
Goldman Sachs (GS) **31, 98**
Google (GOOG) **16, 28, 71, 72**
Grail Partners **13**
GreatCall **24**
GUBA **71**

H
H&R Block (HRB) **42**
Hasbro (HAS) **16**
Hewitt Associates (HEW) **64**
Hewlett-Packard (HPQ) **24, 52**
High Frequency Economics **44**
Honda (HMC) **36, 38**
HSBC (HBC) **14**
Hyundai Securities **46**

I
IBM (IBM) **52, 64**
inDplay **71**
ING (ING) **98**
Inpex **48**
Internet Movie Database (AMZN) **71**
Intuit (INTU) **72**

J
J.C. Penney (JCP) **34**
J.D. Power (MHP) **38**
JMP Securities **42**
JPMorgan Chase (JPM) **34**

K
KB Toys **16**
Keefe Bruyette & Woods (KBW) **42**
Kleiner Perkins Caufield & Byers **71**
Knight Ridder **40**
Kohl's (KSS) **34**
Kraft Foods (KFT) **34**
Kynikos Associates **14**

L
Lawrence Investments **72**
Lazard Capital (LAZ) **78**
Leerink Swann **78**
Lego **16**
Lehman Brothers (LEH) **18, 100**
Lenovo Group (LNVGX) **52**
Lewin Group **110**
Liberty Global (LBTYA) **100**
L.L. Bean **20**
Luce et Studio **84**
Lulu **71**

M
Macquarie Bank **34**
M&R Capital **100**
McGraw-Hill (MHP) **84**
MDB Capital **100**
Megastudy **46**
Merck (MRK) **34**
Merrill Lynch (MER) **36, 42, 72, 98**
Microsoft (MSFT) **13, 28, 31, 52**
Monster (MNST) **34**
Morgan Stanley (MS) **40, 42**
Morningstar (MORN) **98**
MySpace (NWS) **60**

N
Napster (NAPS) **13**
National City (NCC) **42**
National Iranian Oil **48**
NBC Universal **28**
Needham **100**
Nestlé (NSRGY) **34**
Netsuite **72**
News Corp. (NWS) **28**
New York Times (NYT) **40**
Nintendo (NTDOY) **16**
Nissan (NSANY) **84**
Novartis (NVS) **34, 84**
NYSE (NYX) **34**

O
OpenLink **96**
Oracle (ORCL) **72**

P
Panera Bread (PNRA) **38**
Partners Group **13**
PayPal (EBAY **71**
PFC Energy **48**
Pfizer (PFE) **13, 14, 34, 82**
Presto Services **24**
Pump Audio **71**
Putnam Lovell **13**

Q
Qantas **34**
Quadrangle Group **4**

R
RAB Capital **13**
Raymond James **13**
RBS Greenwich Capi **42**
Remote Lands **90**
Renault-Nissan **36**
Royal Dutch Shell **48**
Royal Philips Electro (PHG) **50**
Rubbersidewalks **76**
RxKinetics (ENDP) **7**

S
Salesforce.com (CR
SAP (SAP) **72**
Saxon Capital (SAX
Shawmut Design **96**
Sotheby's (BID) **14**
Statoil **48**
Stubbins Associate
Studios Architectur
Sun (SUNW) **52, 60**

T, U
Target (TGT) **16, 34 60, 98**
TCL **52**
Téran/TBWA **84**
Texas Pacific **34, 5**
Thomson (TMS) **5**
THS/PASD **84**
Time Warner (TWX
Total (TOT) **48**
Toyota (TM) **36, 3**
Toys 'R' Us **16**
TreuHandStelle **8**
Tribune (TRB) **40**
Union Gas **100**
Unocal **52**
US Airways (LCCC
U.S. Rubber Recy

V, W
Viacom (VIA) **13**
VideoJump **71**
Wachovia (WB) **1**
Wal-Mart (WMT) **60, 98**
Washington Mut (WM) **42**
W.L. Ross **18**
W.R. Hambrecht

Y, Z
Yahoo! (YHOO) **2**
Young & Rubican
YouTube (GOOG)
Zattoo **71**

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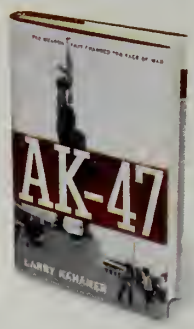


The Reliable Killer

AK-47 The Weapon That Changed the Face of War
By Larry Kahaner; Wiley; 258pp; $25.95

Here's today's puzzler: Name a Russian innovation that whips most everything America and Western Europe throws against it, has astounding firepower, and is unaffected by heat, cold, and sand. (No, it's not Maria Sharapova.) Need more hints? It's easily transported, and its familiar silhouette has made it a must-have fashion accessory certifying the rebel status of figures from the anonymous Viet Cong to Osama bin Laden. Give up? It's the Kalashnikov assault rifle, also known as the AK. Since its first large-scale production in 1947, this low-tech weapon of mass destruction has spread across the globe, doling out death from Afghanistan to the U.S.

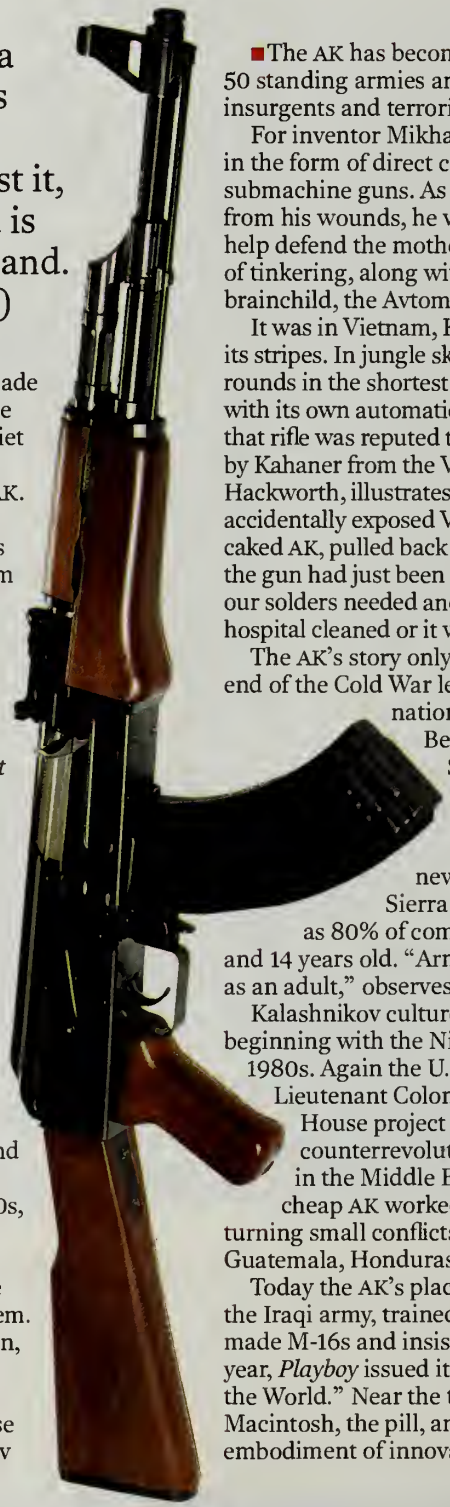
If we need a reminder, the AK is graphic evidence that not every innovation benefits humanity. With one devastating, engrossing anecdote after another, author Larry Kahaner provides a chilling and perversely entertaining brief in *AK-47: The Weapon That Changed the Face of War*. Consider this:

■The AK was first unveiled by the Soviet Army during the 1956 Hungarian uprising. Capable of 600-rounds-per-minute bursts of killing power, the weapon demonstrated its effectiveness while demanding few skills of the poorly trained, largely conscript Soviet army. The revolt was squelched. As many as 50,000 civilians were killed.

■Since that time, around 100 million AKs have been produced. The Soviets chose not to assert patent claims or charge licensing fees, allowing "wholesale production" of the weapon in countries from Bulgaria and Poland to China.

■During the war in Afghanistan in the 1980s, the Soviets introduced an improved AK with a smaller, more lethal bullet. But the insurgent *mujahideen* likewise carried AKs, thanks to the CIA, which donated as many as 400,000 of them.

■With the 1991 collapse of the Soviet Union, hundreds of thousands, perhaps millions, of weapons flooded the globe. In Afghanistan and Pakistan, a huge supply prompted the rise of a thriving black market and a "Kalashnikov culture," in which AKs were everywhere.



■The AK has become the firearm of choice for at least 50 standing armies and uncounted ragtag outfits, from insurgents and terrorists to drug dealers and street gangs.

For inventor Mikhail Kalashnikov, inspiration came in 1 in the form of direct contact with Nazi invaders' Schmeiss submachine guns. As the young tank commander recover from his wounds, he vowed to create a weapon that would help defend the motherland. However, it took him years of tinkering, along with technical schooling, to perfect his brainchild, the Avtomat Kalashnikova 1947.

It was in Vietnam, Kahaner tells us, that the AK really ea its stripes. In jungle skirmishes, whoever pumped out the r rounds in the shortest amount of time won. America count with its own automatic, the space-age-sleek M-16. But for y that rifle was reputed to have problems. One story, plucked by Kahaner from the Vietnam memoir of Colonel David Hackworth, illustrates the issues. Hackworth came across accidentally exposed Viet Cong gravesite, yanked out a mu caked AK, pulled back the bolt, and fired off thirty rounds a the gun had just been cleaned. "This was the kind of weap our solders needed and deserved, not the M-16 that had to hospital cleaned or it would jam," wrote Hackworth.

The AK's story only gets darker from there. In Africa, th end of the Cold War led to cutbacks in aid, fragmentatior national states, and revived tribal rivalrie Beginning in Liberia and spreading t Sierra Leone, Somalia, and Rwanda a new kind of war emerged, mark by vicious attacks on civilians and grotesque atrocities. And there wa new kind of combatant: children. In th Sierra Leone civil war of the 1990s, as ma as 80% of combatants were estimated to be betw and 14 years old. "Armed with an AK, they were just as l as an adult," observes Kahaner.

Kalashnikov culture also spread to Latin America, beginning with the Nicaraguan Contra war of the 1980s. Again the U.S. helped spread the epidemic, as Lieutenant Colonel Oliver L. North's secret White House project shipped thousands of AKs to the counterrevolutionaries. Soon, "just as it had don in the Middle East and Africa, the indestructible cheap AK worked its way from country to country, turning small conflicts into large wars" in El Salvador, Guatemala, Honduras, and Colombia.

Today the AK's place in civilization seems clear. In 20 the Iraqi army, trained by the U.S. military, nixed Ameri made M-16s and insisted on being issued AKs. That sam year, *Playboy* issued its list of "50 Products That Chang the World." Near the top—beaten out by only the Apple Macintosh, the pill, and the Sony Betamax—was the AK embodiment of innovation's dark side. ■

–By Hardy

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IdeasOutsideShot

BY NEWT GINGRICH AND ROBERT EGGE

Let's Pay Up for Alzheimer's

Alzheimer's disease is devastating. It strikes 1 in 10 Americans over age 6 and almost half of Americans over 85—the odds of developing Alzheimer double every five years after 65. There are, so far, no cures, no remissions While it is increasingly common to meet heart attack or cancer survivors you won't meet an Alzheimer's survivor because there are none. Alzheime

always ends in death. Perhaps that's why older Americans fear it more than cancer, heart disease, or any other malady.

Alzheimer's is also tragically predictable on a national level. More than 4 million Americans suffer from the brain-crippling disease. As U.S. baby boomers age, this number is set to triple in little more than a generation. And because Alzheimer's robs capabilities and independence, it's also very expensive. This year the federal government will spend more than $120 billion to support those struggling with it. (But of course, not even the most compassionate and skilled caregiver is able to replace what Alzheimer's takes away.)

The government's current $120 billion tab is only a foretaste of what awaits the nation. Without medical breakthroughs, as the boomers pass through their elder years, federal spending on Alzheimer's care will increase to more than $1 trillion per year by 2050 in today's dollars. That's more than 10% of America's current gross domestic product. With this amount of money on the table, the government simply will not be able to solve its looming fiscal problems if it fails to address the growing Alzheimer's epidemic.

INDEED, THE VALUE OF A medical breakthrough for Alzheimer's would be overwhelming; for instance, according to the Lewin Group, a research advance that delayed the onset of Alzheimer's by just five years would translate by 2050 into a 5.3 million (40%) reduction in disease prevalence and roughly $515 billion (44%) in annual savings for the Centers for Medicare & Medicaid Services.

But that prognosis is unlikely given our present course. Just compare how much Washington currently is spending to defeat this disease, primarily through the National Institutes of Health and the Food & Drug Administration, with the amount it now spends—through Medicare and Medicaid—to cope with the ruin Alzheimer's leaves behind: For every dollar the government spends to treat the impact of Alzheimer's, it devotes less than a penny toward finding a cure.

Caring for the boomers likely to be afflicted will cost far more than finding a cure now

This penny-on-the-dollar approach might be called the Katrina Strategy for Alzheimer's. Policymakers long neglected the work of strengthening the levees that might have saved New Orleans from the worst of Katrina's impa only to later spend more than a hundredfold the cost of fi the levees to rebuild the broken city after the levees failed This is exactly what we're doing with Alzheimer's.

Fiscal hawks in the Bush Administration and Congress rightly concerned about spiraling debt, have been workin to squeeze savings out of the NIH and the FDA. That's understandable but misguided. A broader strategic view would save both lives and money suggests that we shoul be devoting far more attention to finding a breakthrough to end Alzheimer's. At a mini we should provide increased, consistent fun to researchers investigating new approache should also increase funding to the FDA—bu with the charge that it dramatically reduce t time it takes to evaluate prospective Alzhein therapies. With more than 100 trials curren under way, the faster researchers learn whic approaches produce the best results, the be they can focus their efforts.

The good news is that while the new Con and the Administration have inherited this massive problem, they do have the power to quickly set things right. And this is certainl bold, coherent agenda that both Republica and Democrats should be able to embrace.

Can we find a cure? While there are no guarantees, recent advances offer grounds for optimism. Neuroscie researchers are making significant discoveries, and improved imaging technologies are giving us a much de understanding of the disease mechanism, and with it, potential solutions. But to capitalize on these advances, need a new federal resolve to truly defeat Alzheimer's. A America's largest generation ages, we have no time to l

Newt Gingrich, *the former House Speaker, is founder of the Center for Health Transformation.* **Robert Egge** *is a p director at the Center.*

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IdeasTheWelchWay

BY JACK AND SUZY WELCH

Growing Up but Staying Young

Our company is growing fast, and we've started to have trouble organizing ourselves. What is the best way to go from a small company to a big one?

–Ante Milos, Sarajevo, Bosnia and Herzegovina

What a great problem to have. Growth like yours can only mean that you've figured out a strategic "aha"—a new product or service customers really want and competitors don't offer—and that you have an energized team to match. Nice going!

But brace yourself. The leap from startup to going concern is one of the trickiest transitions in an organization's life, and if left to chance, it can make a company come unglued. The problem is that many startups, while installing processes and systems to organize their burgeoning bigness, accidentally kill the spirit and energy that made them so successful when they were small.

That's why your overriding goal right now must be to help your company grow up and still stay young at heart.

Begin by going back to the basics: mission and values. When you were starting out, everyone probably worked together, and people could feel in their bones where you were going and what behaviors were expected of them to get there. But as hires have poured in and operations have dispersed, your mission and values have probably become somewhat fuzzy. That's trouble waiting to happen. Stop it by talking about them *ad nauseam*, always remembering that most people haven't lived them the way you have.

> Growing outfits often put in systems that kill the spirit that made them successful

Your next step is to establish an operating system and rhythm since you've probably gotten along so far using ad hoc forms of budgeting and planning. It's time for the real thing now, but remember: Avoid bureaucratic awfulness. Keep the planning down to a few slides designed to generate lively discussion, and make sure budgeting doesn't devolve into a phony series of negotiations that culminate in a rigid number instead of exciting stretch goals. Whatever you do, never punish people for missing bold targets. Reward them instead based on how their results compare with last year's and how they did relative to the competition or the opportunity.

Speaking of rewarding people, no company can go from small to big without a rigorous, candid appraisal system, conducted at least twice a year. Momentum won't carry you forever, and you must make sure you have the best team. To do that, you will need some systematic form of differentiation, identifying great, average, and sub-par workers so they can be managed up or out accordingly. Unfortunately, in your situation, as with every growing startup, some underperformers are sure to be from the ranks of your original employees. Just because people are Badge No. 6 or Badge No.14 doesn't mean they are stars. Maybe they got lucky, hopping on the train as it was roar downhill but only serving as dead weight on the uphill journey. You can't carry them along for the ride.

Perhaps that challenge is a metaphor for what is so har about the small-to-big transition you're going through. Yo need to let go of the "winging it" part of your past but hol on to the informal, indomitable feel that launched you. Ha stuff. But exciting, too.

You're ahead of the game because you recognize the challenge. Now, you've got a glorious piece of blank paper front of you. The future is yours to design.

What should business school professors—myself included—doing to prepare our students for the global business environment?

–Craig Shoemaker, Davenport,

We'd make the case that the nitty-gritty of managing peo should rank higher in the educational hierarchy. In the p two years we've visited 35 B-schools around the world ar have been repeatedly surprised by how little classroom attention is paid to hiring, motivating, team-building, an firing. Instead, B-schools seem far more invested in teacl brainiac concepts—disruptive technologies, complexity modeling, and the like. Those may be useful, particularly you join a consulting firm, but real managers need to kn how to get the most out of people.

Sadly, at most business schools the people teaching al people rarely get much respect. The big hitters are in str and finance. We'd say that's backward. Strategy and fina matter, of course, but without the right people running t on the ground, they're nothing but theories in the sky.

We hope you have the clout to make sure people management is front and center at your university. If yo you'll launch your students' careers with a real head sta

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BEST WORST of 2006

PAGE 56

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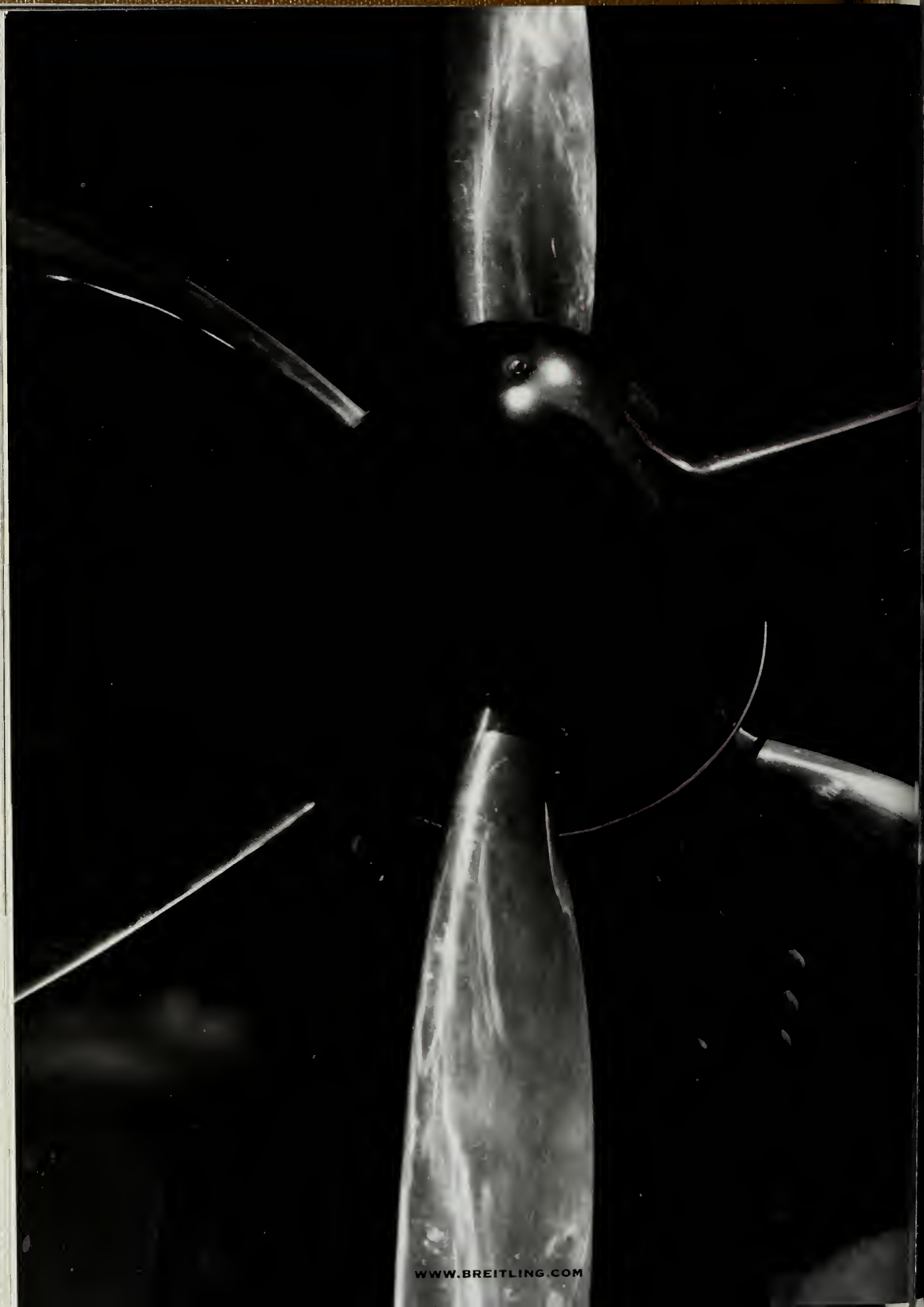
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d stock-sale plans were meant vent executives from trading on information, but they don't seem working out that way

Big Rethink at Pfizer
rugmaker is revising how it bets proven technology after a heart debacle

ll That Glitters At Tiffany's
ath its dazzling earnings lie brand ales problems

esktops Are So Last Century
xes are cheaper, but laptops rule obile, PC-dependent culture

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umers are flush. Foreign tment is up. Then there's the nment interference–and rruption

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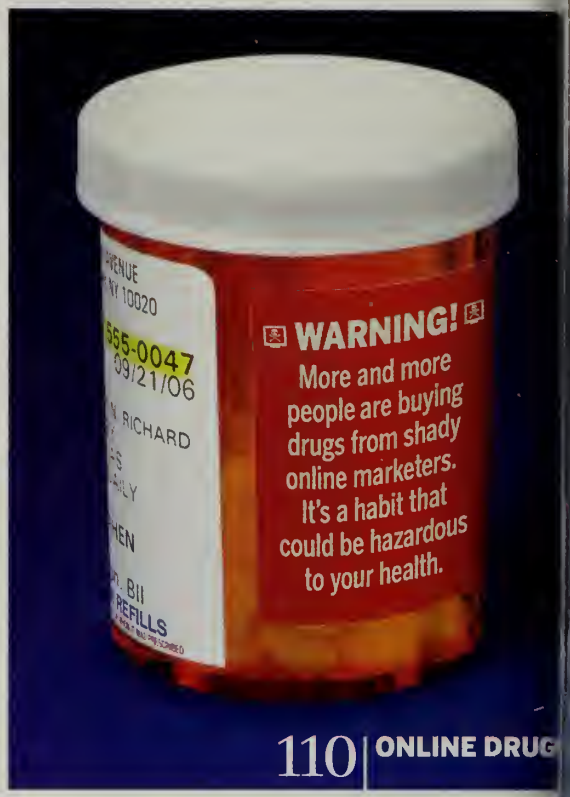
THE BEST & WORST OF 2006

56 Surprise, Surprise! This was a year of unpredictability and even downright weirdness. In our annual Best & Worst issue, you'll find the Leaders, Products, and Ideas that left their mark—or their stain—on A.D. 2006

CONTENTS



Economics

33 The Business Outlook
Jim Cooper says gentler growth and higher productivity should put to rest lingering fears about inflation in 2007

Special Report/ Investigations

110 Bitter Pills: Drug Scams on the Web
More people are buying prescription drugs from shady online marketers—and that threatens Big Pharma

Managing

120 O.K., This Is a Raid
Companies are increasingly lifting whole teams from other companies

Social Issues

124 The Fracas at Boeing
Complications from a dustup with an old-style union boss

The Corporation

126 How Guess Got Its Groove Back
New stores and an aggressive upscale push have the apparel maker strutting the fashion runway

Feedback

129 Feedback: Steamed over Sweatshops
Readers react to our Cover Story about the real conditions in Chinese factories

Environment

132 Put a Termite In Your Tank
Bio-breakthroughs may lead to more efficient ways to make ethanol

Science & Technology

137 Developments to Watch
Red wine's real magic; drones that help G.I.s; better crash barriers

Executive Life

138 Creature Comforts at 30,000 Feet
Singapore Airlines is laying on the luxury

140 No iPod Is an Island
New accessories help it really rock

Personal Finance

146 In Search of a Global Index Fund
Wall Street's quants are on the case

148 Inside Wall Street
Gene Marcial's stocks to watch

150 Figures of the Week

Columnists

18 Kerry Sulkowicz: Analyze This
When two managers are at war

28 Steve Wildstrom: Tech & You
HD radio: Better sound, sleepy programming

32 Jon Fine: Media Centric
And now, *The Small Street Journal*

142 Mike Marrone: My Music
CDs of 2006 with staying power

144 Robert Parker: On Wine
These wines do Adelaide proud

158 Maria Bartiromo: Face Time
Garry Kasparov on the killing of a form KGB operative in London

160 Jack and Suzy Welch: The Welch W
How to stay on the boss's radar

Ideas

154 Best Business Books of 2006
Ten tomes that rose above the rest

Features

13 UpFront
22 Readers Report
24 Corrections & Clarifications
151 Index to Companies

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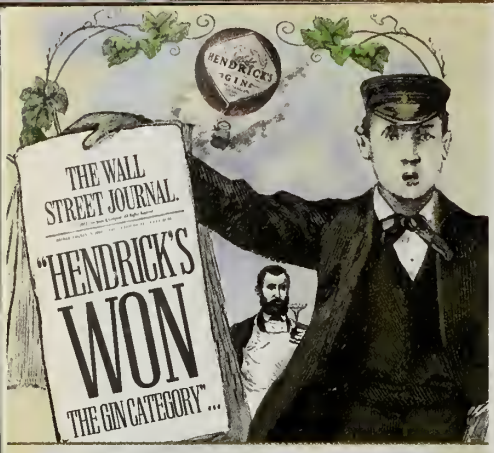

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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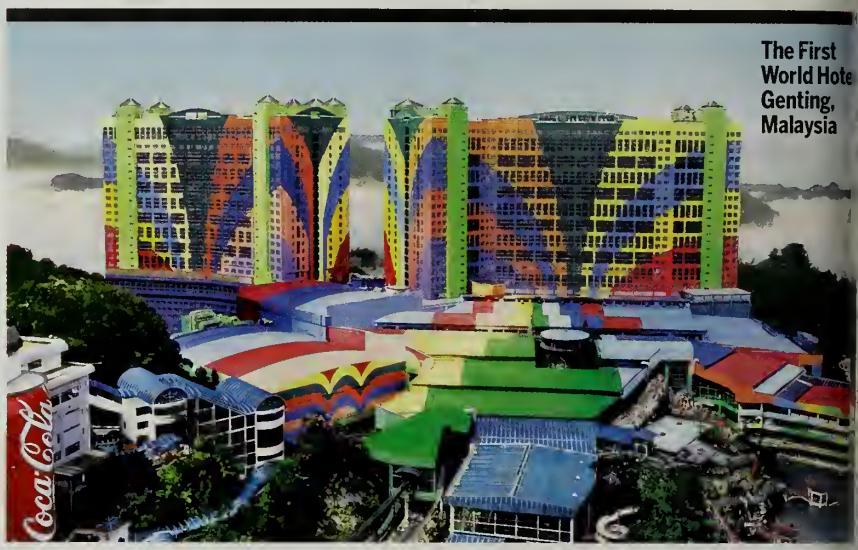

The First World Hote Genting, Malaysia

Modern Marvels

The ancient Roman architect Vitruvius wrote that a building should have "firmness, commodity, and delight." In other words, it should stand up, fulfill a purpose, and look good. It's a rare structure, however, that meets all of these demands. The buildings that do might be said to qualify as **modern-day wonders** of the world—the subject of an on-going series at BusinessWeek.com. Our latest report, on **amazing hotels,** includes the world's highest, perched 53 floors above Shanghai, and largest, the 6,118-room First World Hotel in Malaysia. Inspired by the holiday season, we also have assembled a collection of **innovative houses of worship.** The Vatican still inspires awe, but these buildings are unmatched in their use of new materials to bridge the physical and the spiritual. In other slide shows, we present the wonders of green architecture, **breathtaking bridges,** unique retail spaces, and world-class sports stadiums. And in the coming weeks, we'll unveil the Wonders of 2006—a look at this year's amazing **architectural feats.** Will the Googleplex beat out Apple's dramatic glass cube? Or will a smog-eating museum in Rome make the list? For all this and more, go to **www.businessweek.com/go/06wonders.**

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UPFront

"The bad guys are simply outrunning most of the technology out there today."

–Patrick Peterson, vice-president for technology at spam filtering firm Ironport, to The New York Times *on how spam volume worldwide has doubled in the past year*

ED BY ERIC SCHINE

AIN DRAIN

TALLY ED-OFF RBIE

Y STORES she's a ing princess. But nd the scenes, Barbie cking down doors and g names. In a 58-page plaint filed in federal t in Riverside, ., on Nov. 20, **el Inc.**, Barbie's orate parent, s archrival **Entertainment** its CEO, Isaac an, maker of assy Bratz , and a number of er Mattel employees trade secrets. Mattel s its case on forensic uter analysis. attel claims that in three of its employees exico created a private il account, plot04@ om, that they used to correspond with MGA. One of the employees later tried to destroy his computer's hard drive and use a software program to erase his tracks, according to Mattel.

The complaint says an employee in Canada allegedly copied 45 sensitive company documents onto a portable storage device. Mattel says she labeled the file "backpack" and carried it out of Mattel's offices in a knapsack. The complaint also alleges she spoke to Larian from home that night. She resigned four days later. Mattel alleges this employee later viewed the documents after she started working for MGA.

Larian vigorously denies all the allegations. He says he tells new hires, "Do not bring anything with you except what's in your brain."

–Christopher Palmeri

E BIG PICTURE

U THINK you've got stress? Try running a nily business in China. Asian countries ked tops for stress, while the U.S. and eden came in as the most mellow.

ENTAGE OF FAMILY BUSINESS OWNERS WITH AN "INCREASE" OR IFICANT INCREASE" IN STRESS:

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Data: Grant Thornton International's 2006 Business Owners Survey of 3000 midsize family business owners from 28 countries

PROPERTY LINE

Wall Street Ain't Like Main Street

"PSSST. The housing market is bouncing back. Buy now before it's too late." Heard that one from a real estate agent lately? It's certainly the message emanating from Wall Street, where there's near-panic buying of homebuilding stocks. The **Standard & Poor's** Supercomposite Homebuilder Index rose 17.5% in the month ended Dec. 6, making it the biggest gainer of all 147 S&P groups. The latest jolt came on Dec. 5 after **Toll Brothers** reported a sharp drop in quarterly profits but said that some of its markets "seem to be dancing on the bottom or slightly above."

HOUSING WATCH

But don't feel pressured to come up with a downpayment. What's smart for Wall Street isn't necessarily right for Main Street, or wherever you're looking to buy. Homebuilder stocks are rising well ahead of an actual upturn in housing prices because investors don't want to miss the rally. In contrast, homebuyers have a longer-term perspective and don't need to worry about timing the market bottom.

Besides, who says Wall Street is right? Many economists believe housing prices are still too high in many parts of the country and will keep falling well into 2007. "It just takes a while before sellers finally realize what the real price is. It's not the highest price their neighbors got plus 10%," says James F. Wilson, an analyst for **JMP Securities** in San Francisco.

–By Peter Coy

UPFront

SLIDE SHARING

HAVE I GOT A POWERPOINT FOR YOU

In the beginning, there was MP3 sharing. Then came friend sharing (MySpace), photo sharing (Flickr), and video sharing (YouTube). Now it has come to this: PowerPoint slide sharing.

SlideShare.net offers a place to upload, view, and search for PowerPoint presentations. And since opening up its beta site in October, it has received tens of thousands of files.

The site's "decks," as the slide shows are called, are diverse: conference presentations, classroom lessons ("Let's Learn Colors!" from a middle-school Spanish class), and PowerPoint satire (Abraham Lincoln's *Gettysburg Address* famously summarized in bullet points, created in 2000 by Peter Norvig, Google's research director).

Site co-founder Jonathan Boutelle came up with the service while organizing a conference. It will hardly grab as many eyeballs as YouTube, but corporate firewalls won't block the likes of "Let's Learn Colors."

–Jena McGregor

MOTOWN

GM TURNS ON THE JUICE

EVER SINCE Toyota and **Honda** launched the first hybrids in the late 1990s, Detroit's carmakers have been scrambling to catch up. Now **General Motors** is saying it will launch a dozen hybrids over the next several years, and one of them—a Saturn VUE SUV—will have batteries that you can plug into a standard home outlet.

That may not sound like a big deal, but the added electric power will enable the VUE to get gas mileage of around 70 miles per gallon, compared to 29 for a regular hybrid VUE and 25 for a gas-powered VUE. And the cost of electricity to provide a full charge works out to the equivalent of just 60¢ a gallon.

There could be another big pay-off, too: GM says the technology not only saves fuel but also helps pave the way for an electric drive system that could power hydrogen fuel-cell cars. GM aims to sell affordable fuel-cell autos by as early as 2011.

A plug-in hybrid brings GM's electric vehicle odyssey nearly full circle. GM killed its EV1 electric car program in 2000 because consumers didn't want to plug in their cars for eight hours just so they could go 150 miles on a charge. One reason gas-electric hybrids gained in popularity is that they do ever need an external cha

GM's push for a plug-i hybrid shows how impro auto technology combine with pricey oil is giving n life to GM's old dream. Bu plug-in hybrids aren't pe Once the battery's power runs low, its gasoline eng will have to work harder lug around big, heavy lith ion batteries and an elect motor. That could drop fu savings—especially on lo trips. But if GM can deliv on its promise, the plug-i could go a long way towa buffing GM's long-tarnisl reputation for high tech.

–David W

EXECUTIVE PAY

IT'S FULL DISCLOSURE TIME

EXPECT A BUMPY proxy season. Companies are bracing for shareholder outrage in light of new SEC rules that require them to disclose top executives' total compensation, including the value of pension plans, deferred compensation, and perks. Many compensation experts expect astronomical numbers. Some predict a 2007 bumper crop of new Hank McKinnells. The former **Pfizer** chief was pushed into early retirement this year in the wake of shareholder anger over his pay package.

Compensation consultants Richard V. Smith of law firm McDermott Will & Emery has been telling clients to make changes to pay plans now to deal with any possible future excess compensation issues. Crisis communications adviser Chris Lehane tells clients to be prepared to fire CEOs if they attract too much criticism.

Some companies have already begun changing their compensation plans. **NCR** stopped paying in to the pensions of its top execs. **UnitedHealth Group,** reeling from an options-backdati scandal, eliminated lucrat change-of-control plans. NCR says the changes we made primarily to cut cos UnitedHealth says its cha are part of a broader corp governance plan.

Whatever the exact reason, the moves are ju the sort of steps the SEC looking for. SEC Chairm Christopher Cox, in a sp last March on the intend impact of the rules, put i this way: "I have a feelir that when people are fo to undress in public, the pay more attention to th figures." *–Eamon Javers*

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WIRED LIFE

ONLINE NEWS JUST FOR KIDS

WHO SAYS the younger generation doesn't read the news? **Play Bac Presse,** which publishes popular children's daily papers in France, has just launched an English-language online version in the U.S. called *My Daily 10*. Aimed at 8- to 10-year-olds, it's delivered electronically five afternoons a week. Kids log on after school to read articles such as "Mars Probe Lost in Space." Subscriptions start at $6.99 a month.

My Daily 10 is modeled on Play Bac's French children's newspapers, which have 200,000 subscribers, about two-thirds as many as *Le Monde*. "Kids love getting their own paper every day," says editor François Dufour, who founded Paris-based Play Bac 20 years ago with two friends. Now a $39 million-a-year business, Play Bac ventured across the Atlantic in 1992 with *Brain Quest*, an educational quiz game that has sold 25 million copies in the U.S.

With so much free content on the Internet, subscriptions could be a tough sell. But the paper boasts a big plus: Unlike children's TV and many kid-oriented Web sites, *My Daily 10* has no advertising.

–Carol Matlack

HOLIDAY CHEE
McMahon in Iraq in 2004

IRAQ

VINCE McMAHON has become a modern-day Bob Hope. He and his 50-strong World Wrestling Entertainment group are on their fourth annual holiday tour of Iraq. Good thing, since he's one of the biggest names still visiting the troops. Early on they could see stars such as Jessica Simpson, Kid Rock, and Bruce Willis. Now, as the war drags on, marquee names are scarce. But McMahon and such pro wrestling luminaries as Undertaker and John Cena are touring 2 bases. What's missing this time as a result of all the security concerns, says McMahon is contact with the locals. Says the WWE chairman: "You wouldn't believe how many ardent [Iraqi] fans we have." *–Diane Bra*

BLOGSPOTTING

STARTUP MENTOR

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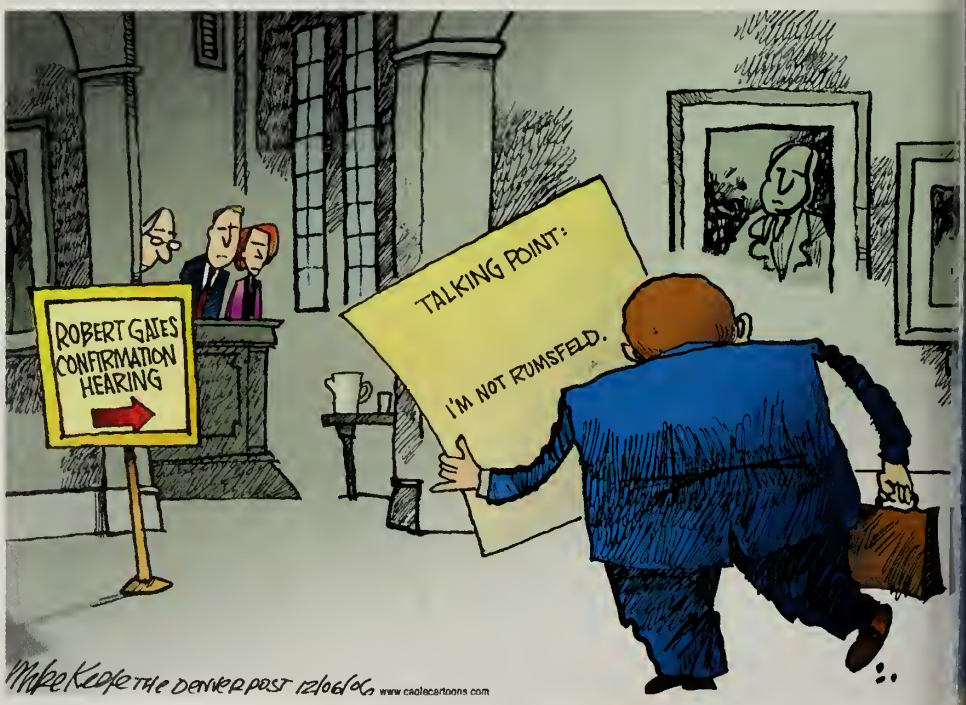
»WHY READ IT Guy Kawasaki, a former product promoter at **Apple** and current venture capitalist at **Garage Technology Ventures,** calls his blog "How to Change the World." That may be a stretch, but it does offer advice with a Silicon Valley slant for marketers and entrepreneurs. Kawasaki, a speaker at conferences, posts tips for pitches and presentations, interviews business book authors, and offers a quiz for aspiring venture capitalists. Says Kawasaki about his unproven track record in the VC world: "When has the lack of knowledge stopped a blogger?"

–Jena McGregor



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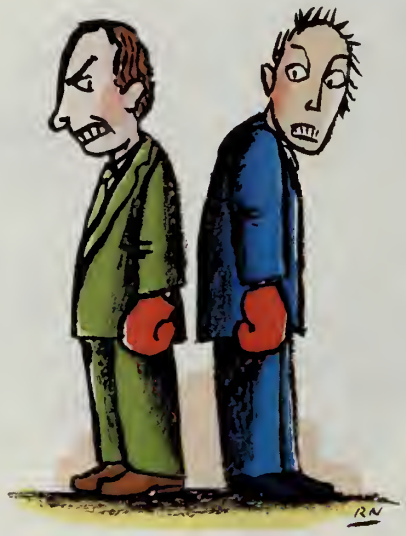
ANALYZE THIS

BY KERRY SULKOWICZ, M.D.

Sparring Execs Need a Time Out

At the company where I work—we make creative products for children—two of the top executives are at war with each other. They go off on rants, they use foul language, and from time to time they actually have shoving matches. Both of these men are top producers, I might add. What lies behind this behavior? And is there anything co-workers can do? We're appalled, but the boss won't step in.

—Anonymous, New Jersey



YOU NOT ONLY work for a company that makes products for children, you also have executives who behave like them. They resemble unruly siblings who can't stop fighting, and it's made worse because there's no parent to step in and exert some benevolent control and help them learn more adaptive ways to interact.

While any number of reasons could account for their unprofessional conduct, your boss's unwillingness to intervene might not only point to the missing solution, but in fact could be part of the cause. A lack of sorely needed authority—which includes the ability to act "parental" when necessary—often precipitates regression in groups. By regression I mean just what you're describing: a retreat from reasonably mature professionalism to a more infantile set of behaviors.

WHAT CAN YOU and your colleagues do, besides feel appalled or demoralized? Don't try to take on the fighting executives directly. That's probably doomed to backfire. Rather than sitting idly by, though, it's worth talking to your boss in a matter-of-fact way, describing not just the executives' behavior but also its effects on the organization. One consequence of the fighting that might interest your boss is its impact on his own credibility as a leader. Few things are as compelling to leaders as their own loss of power and control.

That these executives are top performers doesn't make matters easier, as your boss may be afraid that if he confronts them they be less productive or quit. This common rationalization usually turns out to be an unfounded worry. In my experience working with CEOs who have teetered on the edge of self-destructiveness, I've found that they're ultimately appreciative of someone who reins them in, even if they don't readily admit it. It's not unlike the way neglected children who are acting up secretly hope a grown-up will appear and restore order. On the other hand, your executives already could be more liability than asset, and in the long run it might not be the worst thing if they decided to pack up their toys and go home.

Kerry J. Sulkowicz, M.D., a psychoanalyst and founder of the Boswell Group, advises executives on psychological aspects of business. Send his questions at analyzethis@businessweek.com.

QUESTION OF THE WEEK

What do you make of recent efforts to scale back Sarbanes-Oxley corporate reform legislation?

"Global companies should look at processes that are material to them, not processes that really don't make that much difference. We need to focus only on areas that could create a real risk for the institution. We also need greater reliance on internal audits." *John A. Thain, CEO of the NYSE*

"We have been able to identify a number of ways to make internal control audits more efficient. We are focused on how to eliminate unnecessary costs, particularly for smaller companies, while retaining important benefits" *Mark W. Olson, Chairman, the Public Company Accounting Oversight Board, a nonprofit that oversees auditors*

"Investors have a need and a right to fully accurate finance statements. I'd be very surprised if Congress wants to open that box again. Looking back over the events of the past few months, it's clear we should not be rolling things back." *Jack Ehnes, CEO of the California State Teachers' Retirement System, which manages investments of $153.3 billion*

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> "Many CEO salaries are peanuts compared with [those] of quarterbacks [and] pitchers...."
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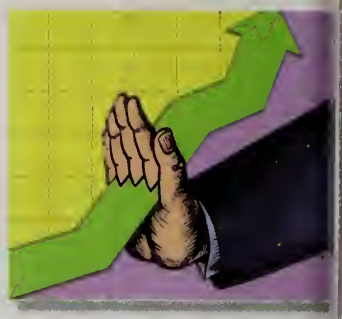
> *–Darin Kendrick*
> *St. Louis*



Editor's Note: For a discussion of our Nov. 27 Cover Story, "Secrets, lies, and sweatshops," please turn to Feedback, page 129.

COMPARED WITH BALL PLAYERS' TAKE, CEO PAY LOOKS STINGY

ALTHOUGH I DISAGREE with the absurd compensation packages that CEOs receive ("How Bill Clinton helped boost CEO pay" Government, Nov. 27), let's not forget that they are not alone. I consider a CEO to have a much greater impact on people's lives, including their careers, retirements, and health care, than any of today's athletes. Yet many CEO salaries are peanuts compared with the salaries of quarterbacks, pitchers, and point guards.

Maybe fans need a quarterly justification for outrageous ticket prices just as shareholders do for CEO pay.

–Darin Kendrick
St. Louis

YOUR ARTICLE REALLY irked me. It was corporate policymakers, not Clinton, who helped boost CEO pay. The fact that Clinton tried to develop a plan to halt excessive compensation and was ultimately unsuccessful was not his fault. The title of your article should have been "I Bill Clinton tried to rein in corpo greed but was unsuccessful."

–Neil Sc
Pikesville,

DUANE READE LAYS OUT A PLAN FOR RENEWAL

"DUANE READE: AN LBO on the cri list" (Finance, Dec. 4) was an interes historical perspective of past challen yet it generally neglected to mention more recent performance or our fu possibilities. Indeed, the company stumble, but that is last year's news.

A new management team is no place, executing against a clearly ticulated six-point strategic plan ca "Duane Reade Full Potential" desig to enhance the customer experie quickly mend our relationship with unions, improve our financial pe mance, and restore the Duane R brand to its rightful position as " York's #1 Drugstore." I am fortu to have a dedicated, loyal team that worked incredibly hard to deliver or mission. Since my team began execu on this mission earlier this year, we meaningfully improved the custome

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BUCKLE UP

perience by enhancing the merchandising, improving customer service, and significantly upgrading the look and feel of our stores. Indulge me as I mention only a few of the many milestones that my team has achieved this year:

• Revenue growth is rising steadily, with third-quarter same-store sales up 4.4%, front-end same-store sales up 5.7%, and pharmacy same-store sales up 2.9%, putting us among the upper tier of our peers.

• Gross margins have shown significant improvement in the first nine months of the year, up approximately 116 basis points.

• Adjusted FIFO EBITDA for 2006 is on track with our initial projection for $60 million to $65 million this year, representing an increase of approximately 50% over last year's $42.2 million. Customer service metrics are improving rapidly.

• We have successfully resolved the legal disputes with our unions.

• Despite the minimum wage increases in early 2006, we have driven down costs –our SG&A margin for the third quarter declined by 56 basis points.

Lastly, it is important to note that the article is about our bonds but fails to mention that our senior subordinated notes have traded to the mid-90s, up from the low 60s, and our senior notes trade above par. Clearly, the debt holders also believe in our future.

There's no doubt that Duane Reade Full Potential requires continued hard work from our committed team. However, the current reality is our customers are buying more and more often, our employees are driving improved in-store service and standards, and bondholder investment has appreciated dramatically. We look forward to writing the next few chapters.

–Richard Dreiling
President and CEO
Duane Reade Holdings Inc.
New York

CORRECTIONS & CLARIFICATIONS

In "The small street journal" (Media Centric, page 32), Jeff Zucker's title is incorrect. His correct title is chief executive officer, NBC Universal Television Group.

"Six Sigma still pays off at Motorola" (The Corporation, Dec. 4) incorrectly stated that Sigma "is used in statistics to measure how far something deviates from perfection." More accurately, Sigma is a measure of variation around the mean.

A photo caption in "Taking tiny loans to the next level" (Special Report, Nov. 27) misidentified Grameen Bank as the source of a loan. The loan came from the Foundati for Credit & Community Assistance, a Ugandan microfinance institution, and was used to buy a village phone operator starter kit from the Grameen Foundation.

KUDOS FROM HARVARD BUSINESS SSCHOOL

HARVARD BUSINESS SCHOOL hea ily agrees with the call by Dean Richa Schmalensee of Massachusetts Institute Technology's Sloan School of Managem to confront real world business proble in business schools ("Where's the "B" B-schools?," Outside Shot, Nov. 27).

Since its founding in 1908, the busin school has had a strong focus on pract in both its research and its educatio programs. During their two years Harvard, our MBA students wrestle w more than 500 case studies that focus "real-life management problems" in r

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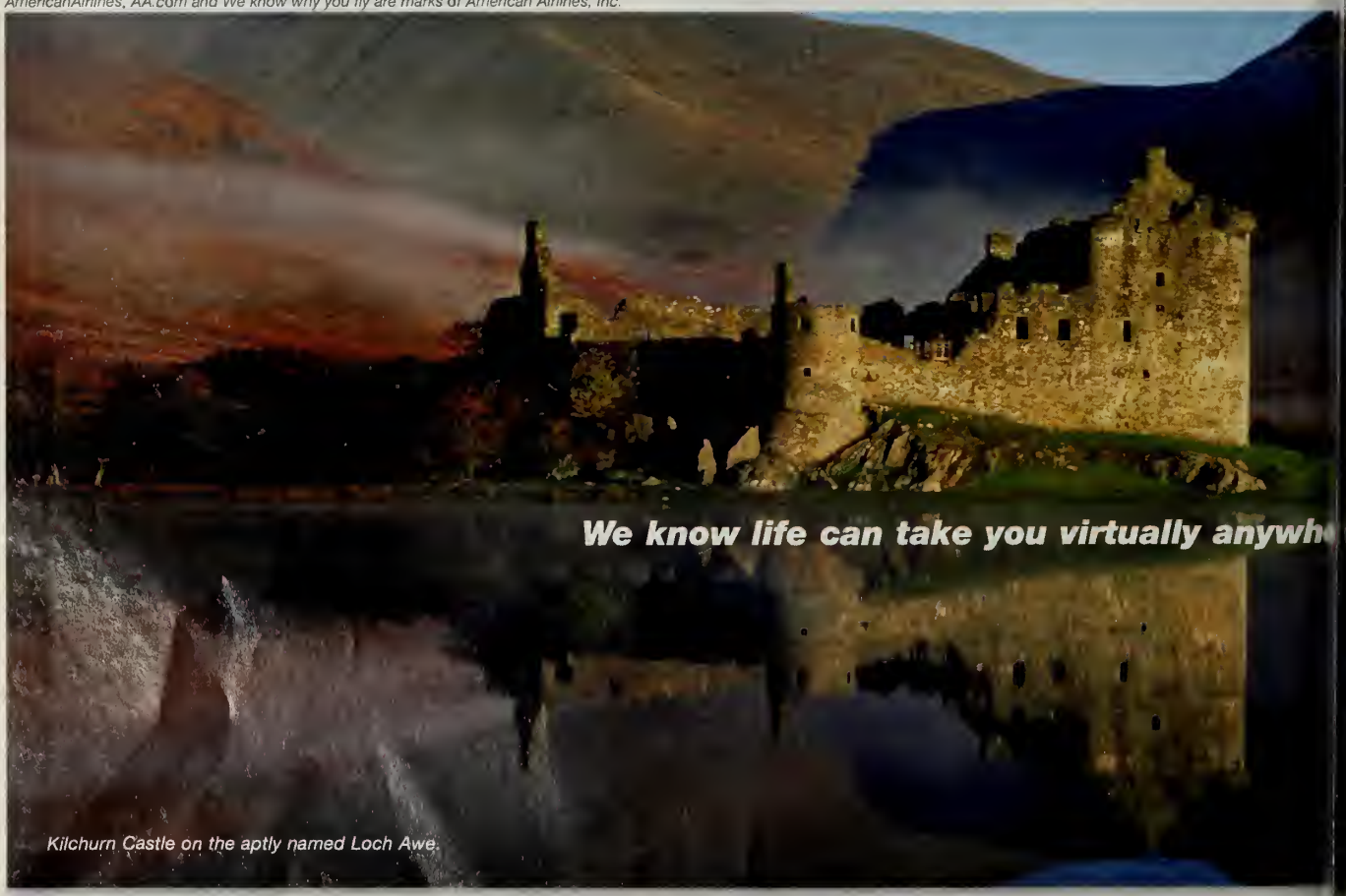

Kilchurn Castle on the aptly named Loch Awe.

nizations. Moreover, as authors of t 80% of the cases used in business ols around the world, our faculty are rect contact with businesses world- on a regular basis, ensuring that the s and insights from their research have relevance in the workplace. In tion, a corps of 15 professors of man- nent practice speak from years of rience as former leaders of entrepre- ial ventures and major corporations. Schmalensee's call to action should eeded. I'm happy to report that we've practicing what he prescribes for st a century.

–Professor W. Carl Kester
Deputy Dean
Harvard Business School
Boston

ULD YOU BUY A CAR HOUT KNOWING ITS PRICE?

AT THE PATIENT PAYS" (Personal nce, Nov. 27) reminded me of my ef- to find out how much a cataract sur- would cost. After leaving the shelter n employer and paying for my own rance and medical expenses, I quick- w that medical providers, with the of insurance companies, are allowed to fix prices. And they fix them high.

Since medical providers and insurance companies have agreed on the price for every procedure, I thought it would be simple to find out beforehand how much a cataract operation would cost, but when I called, my insurance company said the information was proprietary. In other words, I must incur the cost before I can find out what that cost will be!

That blew me away. It flies in the face of capitalism. What if I went to an auto dealer and inquired about the price of a car? Would the dealer say: "After you buy the car, we will tell you how much you have to pay"? How could I compare prices that way? Even an auto repair facility will give you an estimate of charges before you have your car repaired. Why can you not get an estimate before you have your body repaired?

The real answer to this problem is wider access to information. Your article on car salesmen losing commissions because buyers have so much more information than in the past pointed to the reason why medical costs are so high ("Death of the car salesman," News & Insights, Nov. 27). With autos—and almost everything else—pricing information is widely available on the Internet. But when it comes to medical costs, providers and insurance companies are completely in charge of the data.

Technology and the Internet have made it possible to keep prices down in many industries. Why is the medical profession exempt from this process?

–Jared Bessert
Fitchburg, Wis.

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Tech&You
BY STEPHEN H. WILDSTROM

You Heard Right: HD Radio

Most Americans probably realize we are moving to a digital TV format called high-definition television, or HDTV, but few people are aware of its audio counterpart, HD radio. As the name implies, this format aims to deliver big improvements in quality and a wealth of new services. But as with digital television, HD radio's reality falls far short of its promise.

Like its digital cousins, XM Satellite Radio and Sirius Satellite Radio, HD radio relies on special equipment to produce much better sound than conventional analog broadcasts. HD FM offers near-CD quality, about what you hear on XM or Sirius, and HD AM is supposed to approximate conventional FM, according to promoters. But the only digital AM stations I found offered nothing but yak. Both the AM and FM varieties are mercifully free of static and hiss, though with a weak signal the sound breaks up like a bad wireless phone call.

I-SONIC

Unlike XM and Sirius, HD radio is free to anyone with the equipment to receive it. I tried two different systems, the high-end Polk Audio I-Sonic ($599), which can also get XM service, and the much cheaper Radio Shack Accurian Tabletop HD Radio ($179). Not surprisingly, the I-Sonic sounded a lot better and did a better job pulling in weak signals.

Will people spring for this costly equipment just for the superior sound? I doubt it. In the case of satellite radio, it's the programming, not the improved audio quality, that justifies spending $12.95 a month. Alas, HD radio—at least as it exists today—is largely the same vast wasteland as conventional radio, with stations offering short playlists of music in a few repetitive formats.

BECAUSE DIGITAL BROADCASTING uses bandwidth much more efficiently than analog, it is possible to fit two and sometimes three channels onto the same slice of radio spectrum allocated to each station. Unfortunately, not many broadcasters are taking advantage of this opportunity. In the Washington (D.C.) area, there are 18 stations providing HD broadcasts, of which only half offered a second channel. I was happy to see that American University has found a second-channel home for the bluegrass it banished from WAMU-FM but disappointed that WETA-FM hasn't done the same for classical music.

Broadcasters, who are about to start a major ad campaign to promote HD radio, promise a variety of services in the future, including real-time title and artist information, on-demand programming, and the ability to record broadcasts automatically. But to get these features now, you have to subscribe to satellite.

> Yes, the sound is better, but the programs are a yawn

Of course, HD radio faces the same bind as any new entertainment technology. It's hard to draw listeners without a lot of content and cheap players, yet without an audience no one wants to provide the content or build the radios. XM and Sirius are spending tons of their investors' money to create a market, but there's no sugar daddy for digital radio. As for digital television, it has a different kind of patron: Uncle Sam. By 2009 the government will force the transition to HDTV by shutting down analog broadcasting. HD radio has no such deadline.

That makes HD radio a tough sell. For people who like to listen on the road, units for cars are available from Panasonic, Alpine Electronics, and others. But these systems are expensive and typically include satellite radio as well. Right now, only BMW pre-installs HD radios in its new cars.

So why do broadcasters even bother with digital radio? Because they need some way to compete with both satellite radio and digital music players such as the iPod, which get easier and easier to plug into home and car stereos. HD's main selling point is that it's free, but that's offset by the high cost of the radios. The real problem, however, is content. Somewhat better-sounding junk is still junk. The key for the broadcasters is content, not technology. ■

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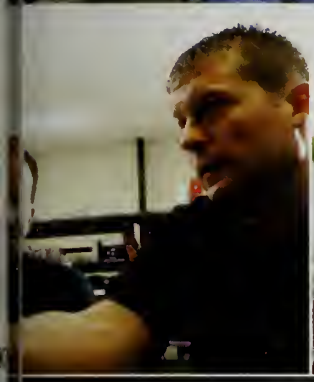

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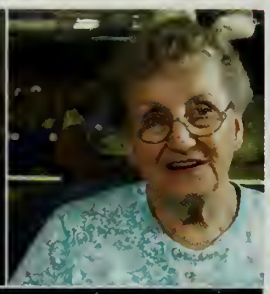

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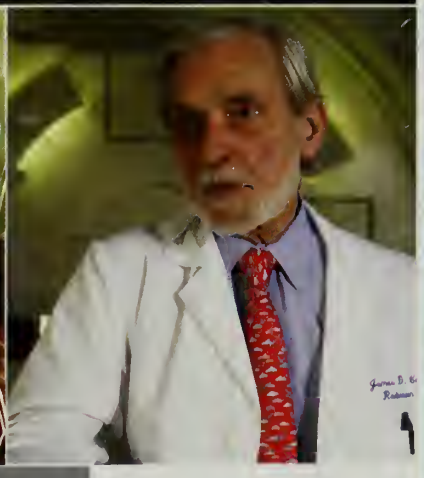

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MediaCentric
BY JON FINE

The Small Street Journal

We will know for sure when it launches on Jan. 2, but the revamped, skinnier *Wall Street Journal* will be the first major American paper to pu significant portions of traditional newspaper functions onto the Web. O so goes the rhetoric at this conceptual stage. *Journal* executives promise direct more breaking and this-happened-yesterday news to its well-

trafficked Web site, leaving the paper itself to focus more on what the news means.

This is a much nicer framework for the *Journal*'s management to erect around the move than if they were merely to admit they're chasing cost savings. The *Journal*'s redesign will squeeze its pages, which will sport five columns of text instead of its current six, and net the company $18 million in newsprint-related savings. Last year the segment at Dow Jones & Co. of which the *Journal* is by far the largest entity lost money. It's expected to be profitable this year, but publisher Gordon Crovitz admits the *Journal*'s profit margin "is not what it should be." Staffers, naturally, brace for job cuts, a topic Crovitz won't address.

NARROWED FOCUS The *Journal* is pushing more news coverage to its Web site

AND HENCE THE CHANGES. In the U.S., there is the five-column, skinny broadsheet, like the *Chicago Tribune* and *USA Today*, and there is the denser and wider six-column format of *The New York Times* and *WSJ*. This extra width makes the *Journal*'s print edition that much more satisfying for gray-haired legacy-media types like, oh, myself. It also makes it a pain to print and distribute in certain areas. No printing plant in Hawaii, for instance, can handle the *Journal*'s current dimensions, which means the *Journal* must fly in its copies every day, which must cost an amount that I am glad I don't have to justify to my corporate overlords. Six columns also means a nonstandard ad size. There were times when the *Journal* could bear these costs of inconvenience, but there was also a time when boxers didn't use gloves. (The *Times* has plans to shrink its page size as well.)

All that said, the *Journal* plays a different game than any other American newspaper. It's the only one that can charge $99 for a year's worth of its Web site. It has long covered a space in which the shelf life of a scoop is measured in minutes, so it has pushed more breaking news to its Web site for much longer than other dailies. This gets into why—if I may get simultaneously retrospective and futuristic—it now seems inevitable that whatever will happen to news will happen to business news first business, informat literally currency. I job touches on inv in any way, not rea the *Journal* can cos enormously, in the way that getting certain data first can m you rich. This made the investment cla among the earliest adopters of ultradig and BlackBerried media habits. Thus t *Journal*'s new approach follows its rea even as it leads U.S. newspapers. It is commendable that the *Journal* is show summation-news out of its newspape pages, but perhaps the more piquant question is: What took them so long? answers may have to do with journal habit and institutional sclerosis—wh course, are hardly exclusive to the *Jo*

The business of business news hasn't been a happy one of late. (M exception: CNBC, which is having banner year.) But new entrants, lik upcoming magazine *Condé Nast Portfolio*, pile in for one crucial reason: Men's attention old-school media may well be waning, but business re one of best ways to reach affluent males. Thus, the mov to protect and squeeze more out of existing franchises. the day the Journal unveiled its redesign, CNBC annou a beefed-up Web site, including a premium pay area. "" know we are getting new competition next year," NBC Universal CEO Jeff Zucker told an investor conference day. He means, of course, the still-unannounced Fox b channel, for which some expect a more aggressive tale search to begin early next year. The business of busine may not be great, but it will be one of the most interest media arenas in '07. ■

BusinessWeek.com For Jon Fine's blog on media and advertisi go to www.businessweek.com/innovate/FineOnMedia

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JAMES C. COOPER

Why the Fed Will Keep Rates on Hold

Slowdown well into the new year will reduce inflation

U.S. ECONOMY Score one for the Federal Reserve. When Fed policymakers sit down to discuss interest rate policy on Dec. 12, they be bound to feel pleased with themselves. Their decision to stop sing rates in August is looking more and more like the right call, ainly because the Fed's economic forecast, made back in July, is ing out right on cue. That is, the economy has slowed gh for Fed officials to feel newly confident about tion pressures abating, but not so much as to raise ns about a recession. It's beginning to look as if no er rate moves—in either direction—will be needed long time.

hat's new in the outlook for the economy and Fed y is the persistence of this year's slowdown. After ing the year at a sizzling 5.6% growth rate, the omy's pace cooled to 2.6% in the second quarter 2.2% in the third quarter. Now recent data suggest th-quarter growth will be no stronger, and might be the weakest of the year. This more somber ern seems likely to spill over into early 2007.

n emerging slower-growth trend is important for nterest rate outlook because it will allow inflation lge down next year, something Fed officials have hoping for. Until this year, the economy has been eding its so-called speed limit, the growth rate the long run that it can sustain without generating tion. If the economy is outgrowing its supply orkers and production facilities, then inflation sures tend to rise.

deed, core inflation, which excludes energy and , accelerated this year. Through October the Fed's erred gauge of inflation was running at 2.4%, above nformal 2% upper limit the central bank favors, and e has been little evidence to indicate it will come n. Until now.

EXTENDED SLOWDOWN through the first quarter ld mean the economy will have grown for four ecutive quarters at a rate below its long-run speed t, generally agreed to be about 3%, or perhaps a le less. In that scenario, inflation pressures tend bside, as was the case during and after the 2001 ssion. Growth at that time averaged 1.3%, and the s inflation measure declined from 2.2% to 1.3%. r 2007, don't expect a drop of that size, since the omy was much weaker then than it's likely to be in coming quarters. Still, it appears that enough slack in abor markets and overall production capacity is now opening up for pricing pressures to gradually abate, in accordance with the Fed's desires.

Chairman Ben S. Bernanke and other Fed officials have recently expressed new concerns that tight job markets and rising labor costs could pressure companies to hike their prices. However, given the economy's gentler pace, job markets are more likely to loosen than tighten further. In coming months, given the unemployment rate's tendency to lag behind growth in the economy, the jobless rate might even edge up a bit.

BASED ON SEVERAL DISAPPOINTING economic reports of late, economists are slashing their growth forecasts for this quarter and the next. Many fourth-quarter projections are now below 2%, with only a bit of improvement expected for the following quarter.

INVENTORIES PILE UP AS DEMAND SLOWS

Data: Bureau of Economic Analysis, Global Insight Inc.

Consumer spending is holding up, but retailers are generally unimpressed by holiday buying, and November car sales dipped to a tepid annual rate of only 16 million. Business outlays for equipment have turned soft, and business spending on new construction, which had been trending up strongly, weakened in October. Falling home construction is also set to take another big bite out of overall growth.

The latest twist in the outlook, and the one most responsible for economists lowering their growth forecasts, is the buildup in business inventories. The pileup was earlier thought to be the result of overproduction in the auto industry, but the problem appears broader, and the necessary adjustments are likely to run into early next year (chart).

Stockpiles this year have grown faster than justified by the slowdown in sales, and contrary to many expectations, overall demand this quarter shows no signs

of speeding up. Total sales of domestically produced items grew at an annual rate of only 2.1% in the middle two quarters of the year, down from 3.8% during the previous four quarters. Meanwhile, inventories have been building. In the third quarter, they rose by the largest amount in more than two years.

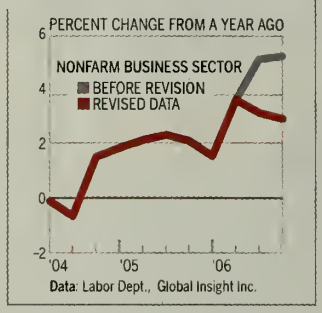
Efforts to pare those stockpiles are cutting deeply into orders and production among manufacturers, although the overall economy is not nearly as weak as the factory sector. That was clear from the November drop in the purchasing managers' index of industrial activity, which fell to 49.5%, the lowest level in 3½ years. For the first time in more than five years, purchasers said their customers' inventories are "too high" for the second month in a row. At the same time, purchasers in the much larger nonmanufacturing sector reported a healthy level of activity in November.

THE CONTINUED SLOWDOWN in economic growth will ease the Fed's concerns about a potential inflation problem spurred by this year's tighter job market and faster-rising worker costs. The Labor Dept.'s latest revisions to productivity and cost data reinforce that view. They show pressure on labor costs building far less rapidly than earlier data had indicated.

The Labor Dept. revised sharply lower the growth in pay to workers in the nonfarm business sector in the second quarter. The revision implies the first quarter's blistering 13.7% annual rate of increase in compensation was a one-time event, fueled by a surge in bonuses, a pattern that may recur in 2007. Through the third quarter, pay is up 4.3% from a year ago, not 6.7% as indicated earlier. And after accounting for the 1.4% rise in productivity over the year, unit labor costs, which are crucial to pricing decisions, have grown only 2.9%, not the alarming 5.3% clip reported previously (chart).

Cost pressures on pricing decisions may be even weaker than those numbers imply. The Labor Dept.'s figures show even slower grow in unit labor costs among nonfinancial corporations, data to which the Fed pays keen attention. Unit labor costs in this secto are up only 0.5% over the past year, because productivity growth has been faster than that for all nonfarm businesses. Note that prices in the nonfinancial corporate sector are up only 1.8% from a year ago. That gap between prices and unit labor costs explains why profit margins remain wide, a big contributor to this year's strong profit growth.

A TAMER LOOK FOR UNIT LABOR COSTS



Data: Labor Dept., Global Insight Inc.

The strength of the economy and the resulting squee on the labor markets have always been the main reason to be concerned about inflation in 2007. Now those worries are abating. An extended period of slower grow will keep the Fed on the sidelines and pave the way for continued noninflationary growth later on. ■

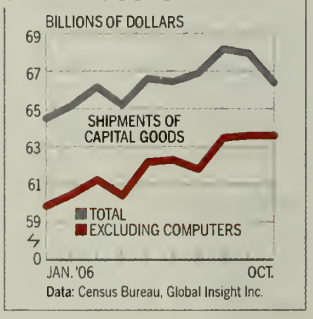
MANUFACTURING

A Lull at the Plant? Look Closer

THE LATEST BATCH of surprisingly weak factory data is leading economists to question the vigor of business investment and to trim economic growth estimates for the fourth quarter. Although manufacturers are in the middle of a slowdown, capital spending should remain a solid contributor to economic growth.

Many economists have downgraded their projections for fourth-quarter 2006 growth, reflecting, in part, recent weakness in capital-goods shipments, which fell sharply in October. November's poor reading on the purchasing managers index of industrial activity, from the Institute for Supply Management (ISM), further fueled new doubts about the quarter's strength.

COMPUTERS DRAG DOWN CAPITAL GOODS DEMAND



Data: Census Bureau, Global Insight Inc.

The truth of the data may be less grim. The 36.2% drop in computer shipments accounts for nearly all of the October decline in capital goods. And as of July, 2006, computer investment in the gross domestic product report is calculated primarily from the Federal Reserve's industrial production numbers because of reliability issues surrounding monthly computer shipments data, says Brent Moulton, associate director at the Bureau of Economic Analysis. The Fed says October computer output remained strong.

And the November purchasing managers' report may not mean factory output fell, as a reading below 50% is often interpreted. According to Edward E. Yardeni, chief investment strategist at Oak Associates, output doesn't start declining on a year-over-year basis until the index falls below 47%.

Weakness in manufacturing still appears to be concentrated in housing and autos. Demand for machinery, a big chunk of capital goods, is still charging ahead. A su in spending on heavy trucks, due to an impending January change i emission regulations, should parti offset the drag in other areas, writ JPMorgan Chase economist Micha Feroli in a Dec. 1 research note. It all adds up to a fourth quarter tha may not be as anemic as the headl numbers imply. ■

–By James Mehring in New

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Executive Suite Shuffle

The corridors of power experienced repeated tremors this week. The most severe came, naturally, in California, where struggling **Yahoo!** on Dec. 5 said it was restructuring. Out: **COO Dan Rosensweig,** who'll leave in March, and **Lloyd Braun,** head of the media group. In: **CFO Susan Decker** (photo), who'll lead one of three operating units and may now be in position to succeed **Chairman Terry Semel.**

Over in earthquake-prone Japan, **Sony Computer Entertainment** on Nov. 30 said that **Ken Kutaragi,** legendary father of the **PlayStation,** will hand daily management of the unit to his deputy in the U.S., **Kazuo Hirai.** Kutaragi will remain CEO and will become chairman of the unit, though his move upstairs is widely seen as a loss of favor. Speaking of which, **Wal-Mart** on Dec. 5 said that high-profile marketer **Julie Roehm** is leaving after less than a year, along with her deputy, **Sean Womack,** but declined to say why. On the same day, **DaimlerChrysler** announced that embattled Chrysler sales and marketing chief **Joe Eberhardt** is departing for a retail job at **Mercedes-Benz.**

See "How Yahoo missed out on the mainland," page 54,
ONLINE *and "Yahoo's shakeup," "New leader for Sony's PlayStation unit," and "Could Chrysler CEO be next to go?"*
www.businessweek.com/go/tbw

Fiasco at Pfizer There goes $1 billion in development costs down the pipeline: Pfizer on Dec. 2 canned its would-be blockbuster drug **torcetrapib** because of bad results in clinical trials. Pfizer shares promptly got sick, falling 11% by Dec. 6.

ONLINE *See "The big rethink at Pfizer," page 42, and "Pfizer's bitter pill," www.businessweek.com/go/tbw*

BONY Bags Mellon Sometimes patience pays off. Nearly a decade after **Mellon Bank** rebuffed its first attempt at a merger, **Bank of New York** finally nabbed its prey on Dec. when Pittsburgh-based Mellon agreed to be acquired fo $16.5 billion. That's $6 billion less than its rival offered t pay back in 1998. The combined company, to be called **Ban of New York Mellon,** would be one of the world's top 10 asse managers and would boast a dominant share of the gritty- but nicely profitable—business of securities processing.

ONLINE *See "The man behind the Mellon merger,*
www.businessweek.com/go/tb

Closed Skies? Less competition and higher trans-Atlan tic air fares: not exactly what the business traveler ordere But those are the likely results of the **Bush Administration** Dec. 5 decision to scrap a proposal that would have give foreigners the right to own up to 25% of American carr ers. For now the move effectively scuttles an "open skie treaty with the **European Union** that would have opened t London's Heathrow airport and allowed EU airlines to f across the Atlantic from anywhere in the Union.

Here Comes Hank On Dec. 5, **American International Grou** settled a raft of legal spats with longtime business partn **C.V. Starr,** a commercial insurer controlled by ousted AIG CE **Maurice "Hank" Greenberg.** The two sides had been feudin over everything related to the C.V. Starr trademark, all th way down to its domain name, which AIG claimed to ow Although the two sides are still fighting over other issue Greenberg can devote more time to making good on a vo to build Starr into an AIG rival.

Betting on Casinos The action is getting hotter in L Vegas. **Frank and Lorenzo Fertitta,** the top two execs at **Stati Casinos,** offered to take their company private for $4.7 bi lion, plus assumption of $3.4 billion in debt. They wou be joined by Los Angeles real estate investment firm **Colo Capital.** Station is the largest player in the so-called loca market. Its specialty is off-the-Strip properties catering Vegas natives. The deal is the latest in a string of casino a hospitality buyouts complete or in the works, including o for industry leader **Harrah's Entertainment.**

Chip Wars It's the battle of the other chipmakers. **Intel** a **AMD** may be duking it out in the PC arena, but **Qualcomm** a **LSI Logic** have set their sights on handhelds and networki LSI said on Dec. 4 that it will buy **Agere Systems** for $4 billi to try to grab new business with hard-drive maker **Seag** and giant **Samsung Electronics.** The same day, Qualcomm s it would acquire **Wi-Fi** chip company **Airgo Networks** for undisclosed sum and the **Bluetooth** business of **RF Micro I vices** for $39 million. That will bolster Qualcomm's pate and may help counter Intel's push to dominate the fledgi **WiMAX** wireless networking standard.

ONLINE *See "Plenty of deals in the chip*
www.businessweek.com/go/t

Airbus, Hat in Hand? The European planemaker Dec. 4 unveiled plans for a jet to challenge **Boeing's** h

ng **787** but omitted one little detail: where it will get h $15.5 billion needed to develop the **A350 XWB**, or Extra le Body. Airbus says it will tap cash flow, but there won't nuch available for five years as it digs out of a $6 billion e caused by production snarls on the **A380** megaplane. nwhile, Airbus' woes deepened as leasing company deferred a 10-plane order for the A380 and **Lufthansa** eared close to buying 20 of Boeing's updated **747s.**

ONLINE *See "Can Airbus afford the A350?" and "Boeing scores a jumbo coup," www.businessweek.com/go/tbw*

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na's R&D Prowess If you're still thinking of China nainly a low-cost manufacturing colossus, think again. Dec. 4 the **OECD** released a study showing that China is ly to spend $136 billion on research and development 006, outpacing Japan's $130 billion and putting China econd place behind the U.S. True, America still leads by ng shot, with an expected $330 billion in R&D this year. China's spending on R&D as a percentage of GDP has e than doubled in the past decade, rising from 0.6% in 95 to 1.2% in 2004.

Class It's high fives all around at 55 investment firms owing the Dec. 5 decision of a federal appeals court in w York to nix a class action that accused them of manipuing the price of IPOs during the late '90s tech boom. The ms, brought on behalf of small investors, are "bristling n individual questions," the court ruled, making a class con inappropriate. While a big victory for the banks, the ng is an equally big blow to **Milberg Weiss Bershad & Schul-**, one of the plaintiffs' lead law firms. Milberg is already ing after it and two of its partners were indicted in May paying kickbacks to clients.

Edict of the Week

w York City is determined to make its residents healthr, whether or not they're interested. On Dec. 5 the y's **Board of Health** voted to ban artificial trans fats at restaurants, making it the first city in the nation to tlaw the artery-clogging substances. Eateries must p using most frying oils and spreads containing trans s by next July, and have until July, 08, to eliminate trans fats from s used for deep frying doughnuts d the like. **Mayor Michael Bloomberg** bied hard for the ban, just as he shed for one of the nation's toughet antismoking laws in 2003. The y's finest restaurants sniff that they uld care less because they wouldn't ch the stuff, but fast food joints e trans fat addicts. Still, **McDonald's** has already said it's perimenting with alternatives, and **Wendy's** introduced ro-trans fat oil in August. Trans fats are believed by ny experts to be particularly harmful to the heart.

TRANS FATTY FRIES

ONLINE *See "Why McDonald's isn't free of trans fat," www.businessweek.com/go/tbw*

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STOCK SALES

INSIDERS WITH A CURIOUS EDGE

How corporate executives seem to be violating the spirit, if not the letter, of a rule meant to prevent insider trading

BY JANE SASSEEN

THE CONFUSION OVER corporate executives trading on inside information never seems to go away. In 2000 the Securities & Exchange Commission came up with a way to remove the guesswork over when it's legal to trade and when it's not. But a raft of recent trades by executives suggests the plan might not be the cure-all that was hoped for.

The SEC's solution was to create prearranged trading plans, known as 10b5-1 plans for the rule that authorized them. Launched six years ago, they were designed to remove discretion from executives' trades and provide a "safe harbor" from insider trading charges. The rules: Executives can't set up a plan when they possess material inside knowledge, and they must set the dates or prices of their trades in advance.

But those are the only major stipulations. The SEC never addressed the number of shares sold or the possibility of stopping and starting plans or running multiple plans at once. As a result, executives have far more flexibility than is generally understood. Besides providing legal cover, the plans allow execs to trade around earnings announcements and other significant events. Normally insiders are prohibited from trading on these "blackout dates."

Executives appear to be using their flexibility to the max. People selling shares in 10b5-1 plans generate returns substantially better than would be expected if the trading were truly automatic. As reported in *BusinessWeek* on Nov. 6, Alan D. Jagolinzer, an assistant professor at Stanford University Graduate School of Business, recently completed a study of roughly 117,000 trades in 10b5-1 plans by 3,426 executives at 1,241 companies. He found that trades inside the plans beat the market by 6% over six months.

Those numbers imply that the rules allow execs to benefit from inside knowledge. "The SEC's intent was to shelter people who didn't have any [material] inside knowledge from liability," says Jesse M. Fried, a Stanford law professor and expert on executive compensation who has viewed Jagolinzer's study. "But that o performance suggests instead that the people using what information th have who are most often entering i trading plans." Says Walter G. Riccar deputy director of the SEC's Enforcem Div.: "Setting up a 10b5-1 plan wh in possession of material informatio could be securities fraud."

BusinessWeek examined a datab created by Thomson Financial of com nies that had suffered a 20% stock sl in the past year and, from that gro focused on the roughly 150 where ecutives had used 10b plans and where sign cant trading—both ins and outside plans—h taken place.

The results? *Busin Week* found a surpris amount of leeway over p planned trades. At nea half the companies exa ined, sales were conc trated in the months le ing up to a stock's peak just thereafter. Frequen the number of shares s

> Execs can stop, restart, or amend trading plans that are meant to be prearranged and automatic

increased as the stock hit new highs, then trailed off or ended as the stock dove.

There are many possible explanations. One, says Michael Painchaud, president of Market Profile Theorems Inc., a Seattle executive trading tracker, is that top officials often know about a company's prospects long before the information is considered legally "material." Another explanation: Many executives pay close attention to valuation levels and decide to cash out after they've seen a big rise. "Insiders know that institutional traders can be very fickle and that money will go elsewhere if their momentum starts to slow," says Mark LoPresti, who follows executive trades for Thomson Financial. In fact, sales in some plans are automatically triggered when stocks reach certain price targets.

Still, the words "prearranged trading plans" bring to mind a steady pattern of trading over a long period of time. When discussing their plans, companies tend to reinforce that perception, says LoPresti. But in reality, many executives sell huge numbers of shares in a very short time, and often right before a tumble.

SWEET RIDE

CONSIDER RECENT TRADES made by Paul J. Sarvadi, chairman and CEO of Administaff Inc. Shares of the Kingwood (Tex.) provider of personnel management services soared from about 15 in May, 2005, to around 42 at the end of October. During that span, Sarvadi used a trading plan to sell shares worth an average of around $2.3 million a month. When the stock plateaued in November, his sales stopped. By spring, after the stock began another ascent, Sarvadi was ready to sell again. He instituted a new trading plan on Mar. 9, and from Apr. 3 to May 1 sold shares for $19 million.

His timing was impeccable. The last trade was at 59. On May 2, Administaff posted strong first-quarter earnings, but second-quarter forecasts disappointed investors. By May 3 the stock had plunged 25%, to 44, then slid to around 31 by late July. Administaff declined to comment.

RED HAT'S SZULIK

Matthew J. Szulik, chairman and CEO of software maker Red Hat Inc. appears to have had similarly good timing. After the stock nearly tripled in 2005, he began selling shares through a plan on Jan. 5, 2006, with sales of 1 million shares for $24 million. From late January to June, he sold roughly 1 million more shares for $28 million. The stock hit 32 in May. But weaker-than-expected results in the June and September quarters sent the stock tumbling, to around 16. Red Hat declined to comment.

Analysts say such results aren't so surprising when trades are made right after plans are put into effect. But in many cases plans put in place long before trades begin also seem presciently timed.

Take the slew of trades made by executives at health insurer Aetna Inc. earlier this year. From early October to mid-November, 2005, three execs set up plans through which they sold shares during the mont of February, 2006. As th stock peaked above 50- up from 10 three year earlier—Chief Financia Officer Alan M. Benne sold 233,333 shares wort $14.2 million, Senior Vice President Craig R. Calle cashed out for $3 mil lion, and John W. Row who retired as CEO tha month but remained e ecutive chairman throug September, sold shares f $44 million.

The stock peaked o Feb. 23. Some analys began raising questio about whether Aetna ha priced its policies too a gressively the previo fall. Those fears appear to be confirmed in April when results f the March quarter showed that Aet was spending a higher portion of premiums providing care than it h a year earlier. The stock lost 20% one trading day. In July, when secon quarter numbers showed things getti worse, shares fell 17% in a day. An Aet spokesman says selling was part of th "systematic planning" for retireme and other things.

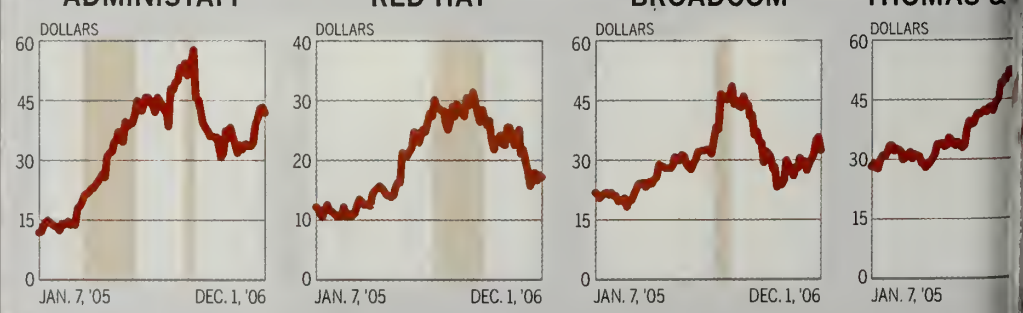
The Aetna example points to anoth issue: groupthink. Companies stress th trading plans represent the personal nancial decisions of executives to div sify holdings and have nothing to do wi anyone's opinions on the stock's pr pects. Yet in many cases more than o executive seems to arrive at that perso decision at the same moment.

In late April, for example, after a 1 month run in which shares of Memph based electrical manufacturer Thom & Betts Corp. doubled, to almost two top officials began selling shar Over the next six weeks, CEO Domi

HAPPY RETURNS

Many insider sales made through trading plans appear to be impeccably well-timed. A few examples, with executive trades in the shaded areas:

Data: Bloomberg Financial Markets, Edgar Online, Yahoo! Finance



tting up a trading plan "while in possession of material rmation...could be securities fraud," says the SEC

eggi sold $7 million worth of stock, h CFO Kenneth W. Fluke sold $6 mil- or vorth over five weeks. In June, as the ompany's growth slowed, the stock fell el 50; a month later it was down to 5. homas & Betts declined to comment h than to say the plans were set up in ic March.

A other curious pattern: a sharp rise s ling. Broadcom Corp. CEO Scott A. Ic egor sold shares from May, 2005, ur gh March of this year. But while his ut natic sales in 2005 averaged 2,750 na s a month for around $110,000, nuary his trading went into over- ri. From Jan. 3 to Mar. 2 he sold on 350,000 shares for almost $19 il on. Many of those sales came as the o surged toward 46 on Jan. 27 on et r-than-expected performance. After na sts slashed their earnings estimates pril, the stock began a three-month id to around 22. While the stock was so hurt by probes into Broadcom's o options practices, in July it also i hird-quarter growth would fall well el forecasts. Broadcom did not re- o d to repeated requests for comment.

m arly, Netflix Inc. CFO Barry W. Mc- ar y Jr. sold 4,000 shares a week from o mber, 2005, to July, 2006. But on o 19—less than a week before the o peaked at 31—McCarthy sold an ld ional 40,000 shares for $1.2 million. et x declined to comment.

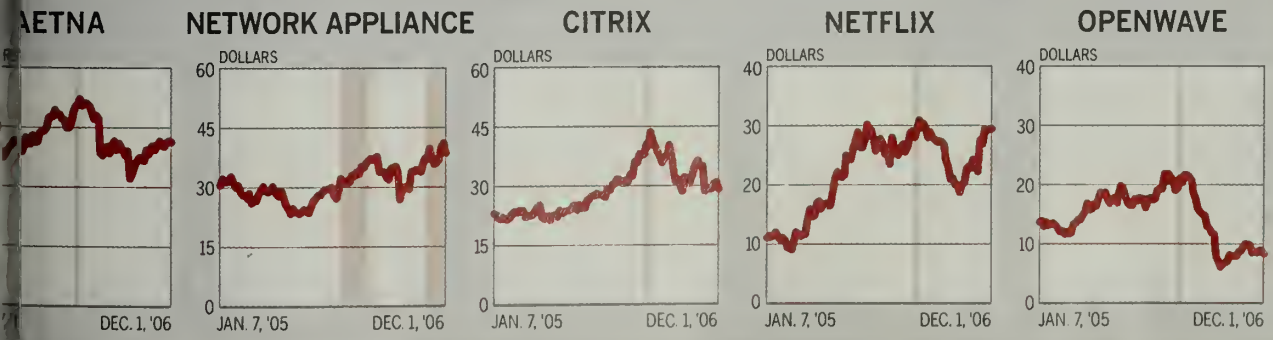
A alysts say executives' outperfor- a e in 10b5-1 plans may be magnified e fact that they can sell just before or te earnings are announced, or on oth- ackout dates when significant news fe s stock prices. "That gives them a dvantage over their co-workers," y Thomson Financial's LoPresti. "Not al can they trade on more days, [but] those days surround pivotal events." John C. Burris, senior vice-president at network software maker Citrix Systems Inc., sold 310,000 shares on Apr. 21 for $12.6 million, two days after strong first-quarter numbers sent the stock soaring 5%. Citrix did not respond to requests for comment.

Despite the "prearranged" nature of the trading plans, executives have enormous flexibility to start, stop, restart, and amend them at will. Some use the plans to trade just once; others use overlapping plans. At software maker Openwave Systems Inc., Chief Administrative Officer Steve Peters set up a plan on Jan. 31 to sell roughly 17,000 shares in early March for $308,000. On Feb. 8 he set up another plan to sell 73,506 shares on Mar. 13, which he unloaded for $1.48 million. By April the stock had started a sharp drop from around 22 to 6 as investors bailed out in the face of weakening profits and an SEC probe into whether Openwave had backdated options. "If [executives are] ending plans and starting new ones with each trade," says Berkeley's Fried, "how does that differ from simply trading outside of a plan?" Peters no longer serves as CAO; he does, however, remain a part-time adviser. Openwave doesn't comment on individual employee trading plans.

BROADCOM'S McGREGOR

Starting and stopping plans at will can enable execs to hit multiple stock peaks. After shares at storage technology outfit Network Appliance Inc. rose 28%, to around 30, late last year, CEO Daniel Warmenhoven set up a plan under which he sold 600,000 shares for roughly $20 million from January to March. The sales stopped just before weaker earnings sent the stock tumbling below 28. In late August, after performance started to mend, Warmenhoven set up a new plan. Starting in mid-September he sold shares worth $15 million as the stock rose into the high 30s. His most recent automatic trade? Forty thousand shares, worth $1.6 million, on Nov. 16, a day after a strong earnings report sent the shares up 5%. Network Appliance didn't respond to requests for comment. ■

–With Megan Tucker, Nichola Saminather, Lorraine Woellert, John Cady, Susan Zegel, and bureau reports



PHARMACEUTICALS

THE BIG RETHINK AT PFIZER

After a heart drug debacle, it's reassessing the way it bets on unproven technology

BY ARLENE WEINTRAUB

DAVID L. SHEDLARZ' recent claim to fame was being passed over for the position of chief executive at Pfizer Inc. last summer. Now, as vice-chairman, he's got what might be an equally tough assignment. Following a debacle in which the company was forced to halt work on its most promising new heart drug, Shedlarz is in charge of overhauling the process of licensing and co-developing products invented by other drug companies. Such deals represent Pfizer's best chance for restocking its drug pipeline before 2011, when its $12 billion cholesterol treatment, Lipitor, loses patent protection.

For starters, Shedlarz plans to shatter the barriers that have prevented several proud Pfizer units from functioning as a team. That should unclog communications channels so that executives can spot unpromising deals and nix them early on. He'll also closely monitor what Pfizer's competitors, large and small, are doing in the same treatment areas. Shedlarz will broaden the definition of collaboration beyond mergers and licensing to include co-promotion deals, equity investments, and other options. These changes, he says, will allow Pfizer "to better assess opportunities and be more disciplined in the amount of money we put on the table."

WALL STREET YAWNS

PFIZER'S OLD APPROACH was disjointed and bureaucratic. One group of executives responsible for licensing drugs from other companies reported to research and development. Acquisitions were handled through the finance department. And a separate venture capital team was assigned to find and fund innovative startups. As Shedlarz admitted at a Nov. 29 meeting for Wall Street analysts: The structure "didn't serve us well."

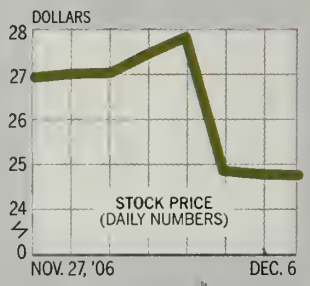
So far Wall Street has greeted the new plan with yawns. "You go to analyst meeting after analyst meeting, and everybody tells you they're trying to be more efficient," says Stephen M. Scala, an analyst with SG Cowen & Co. "Pfizer's restructuring is not dramatically different from other companies'."

Nor is it clear how the new structure will save Pfizer from making more bad bets on unproven technology. The problem isn't just that its researchers sometimes back the wrong drug candidates in their own labs. Like all drug companies, Pfizer depends on licensing deals with biotech companies that are trying to pioneer radical treatments. In the past year alone, drugmakers may have poured as much as $17 billion into such deals, estimates life-sciences merchant bank Burrill & Co. Pfizer was an early convert to this strategy, with results that have been mixed at best.

In 2003, for example, Pfizer joined with San Diego-based Neurocrine Biosciences Inc. to develop an insomnia drug, promising the startup as much as $400 million in payments and the capital to build a sales force. This summer the Food & Drug Administration declined to give the treatment a clear green lig and Pfizer pulled out of the deal a w later. Likewise, in 2003, Pfizer comm ted nearly $300 million to co-developi Macugen, a drug to treat macular deg eration, a blinding disease. Outshone a competing drug from Genentech In Macugen has had sluggish sales an unlikely to contribute much more th $50 million a year to Pfizer's top li some analysts say. In November, Pfiz partner, OSI Pharmaceuticals Inc., sai would exit the eye-disease market.

Shedlarz believes that by bring together experts who used to assess s deals independently, Pfizer will be l likely to stumble into investments w limited market opp tunity. And "better ordination will help understand what ot companies are wo ing on and who mi have interesting p nering opportuniti he says.

PFIZER'S HEARTACHE



Data: Bloomberg Financial Markets

Shedlarz' miss grew more urgent Dec. 2, when Pfi pulled the plug on its perimental drug tor trapib. An independ board monitoring clinical trials repor an unusual number deaths among patie taking the drug, wh was designed to r HDL, the "good chol terol," while lower the bad. Pfizer has nounced job cuts, a there could be more the works.

With about $20 lion in cash and lit debt—a balance sh that Shedlarz help build in his 10 ye as chief financial o cer—Pfizer certainly the resources to buy way out of the hole torcetrapib left in its pipeline. But meet its goal of launching two produ every year on the basis of partnershi the drugmaker will have to master art of sifting the winners from the lose If Shedlarz' program succeeds, Pfizer have a shot at repeating its one brilli success in this area: In 1996, it licen Lipitor from Warner-Lambert, which later acquired. ■

–With Michael Arndt in Chic

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RETAIL

ALL THAT GLITTERS AT TIFFANY'S

Earnings and shares are up. But look beneath the surface

BY LOUISE LEE

AT TIFFANY & CO.'S FLAGship store on New York's Fifth Avenue, a huge clot of people waits for the elevator to the second floor, where some of the priciest baubles reside. Once they arrive, couples ogle display cases featuring items like the rose-cut diamond Fleur necklace (that'll be $110,000, please) and the green-tourmaline-and-aquamarine bracelet ($86,500). Customers sip Perrier while jazz plays in the background.

Shopping at Tiffany's is a seductive experience, particularly in the high-end realm: Sales growth in items costing $20,000 and up is outstripping that of cheaper goods. But it was a sparkling 23% earnings gain that caught investors' eyes recently. Tiffany's Nov. 29 earnings report showcased a 9% jump in U.S. retail sales, with the Fifth Avenue store boasting a 13% rise in sales from a year ago. Numbers like that, coupled with an upward revision to earnings guidance for the year, have sent Tiffany's stock up 9% in six days.

A closer look at earnings reveals a less lustrous picture. A one-time gain from the sale of investments accounts for three of the quarter's 4¢-per-share gain. A high level of share buybacks—some $100 million worth—supported earnings per share. Operating earnings rose 10.7%, but the operating margin was flat and is down for the first nine months of the year. Tiffany executives declined to be interviewed, citing a quiet period.

Easy comparisons year-on-year also helped earnings. The latest quarter marked the first time in years there was no remodeling in the New York store, likely helping sales. Remodeling also plays into the 21% gain in same-store sales in Europe, where sales fell 1% a year ago. London accounts for half of European sales, and half of London sales come from Tiffany's main shop, on Bond Street. A year ago the store was undergoing an extensive renovation, depressing sales. The revamp increased store selling space by 60%, so some of the recent strength reflects sales in new square footage, not higher sales in existing space.

Buybacks helped earnings per share, and Japan sales are down

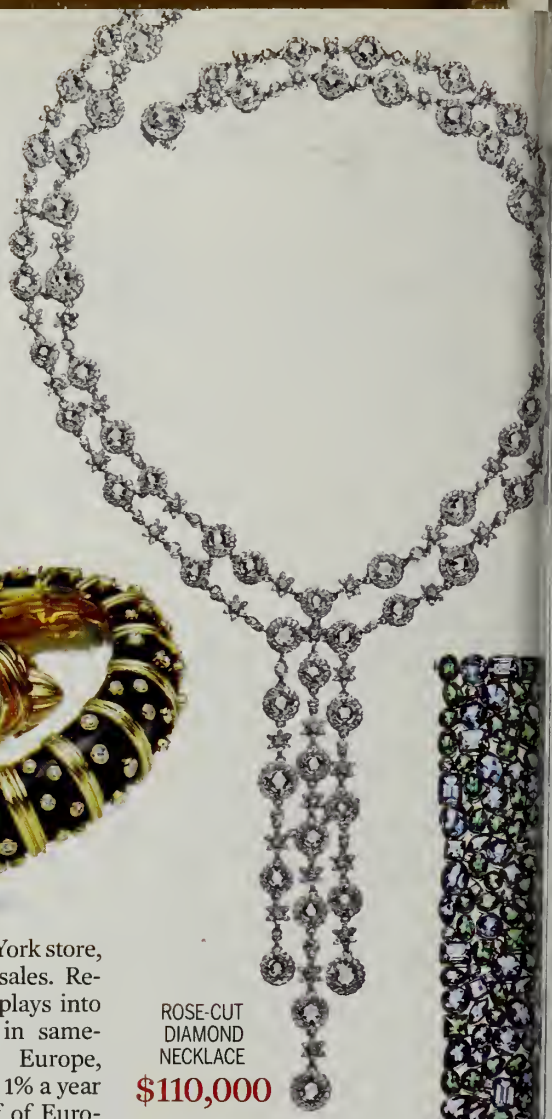
A worrisome issue is Tiffany's struggle with product mix. The big-ticket bias is an attempt to bolster brand image, which began to suffer in 2001 after Tiffany started promoting a low-priced, highly profitable silver jewelry line. It took off, but Tiffany worried that its very popularity damaged the brand's exclusive allure.

Problem is, glam items aren't as profitable as cheaper adornments. The cost of materials and labor to make a diamond-and-platinum necklace is high relative to the price Tiffany can charge; it can mark up less expensive jewelry more. In general, diamond jewelry has a gross margin of about 50%, vs. 70% for silver goods, estimates JPMorgan Chase. With Tiffany saying the "greatest growth" is coming from products with precious stones, lower-margin items likely account for a bigger slice of the pie. That helped send Tiffany's gross profit margin to 53.5%, from 54.1%. It doesn't sound like much, but in the jewelry biz, every fraction of a point counts.

Yet another challenge comes from Japan, which accounts for 20% of sales. Same-store sales there fell 5%, marki the first quarterly decline since ea 2005. The retailer is working to rebu buzz amid fierce competition. On Tiffany does that, the trick will be translate it into high-quality profits. ■

–With Megan Tucker in New Y

ENAMEL BANGLE BRACELETS
$25,000, $65,000



ROSE-CUT DIAMOND NECKLACE
$110,000

TOURMALIN AQUAMARI BRACELE
$86,5

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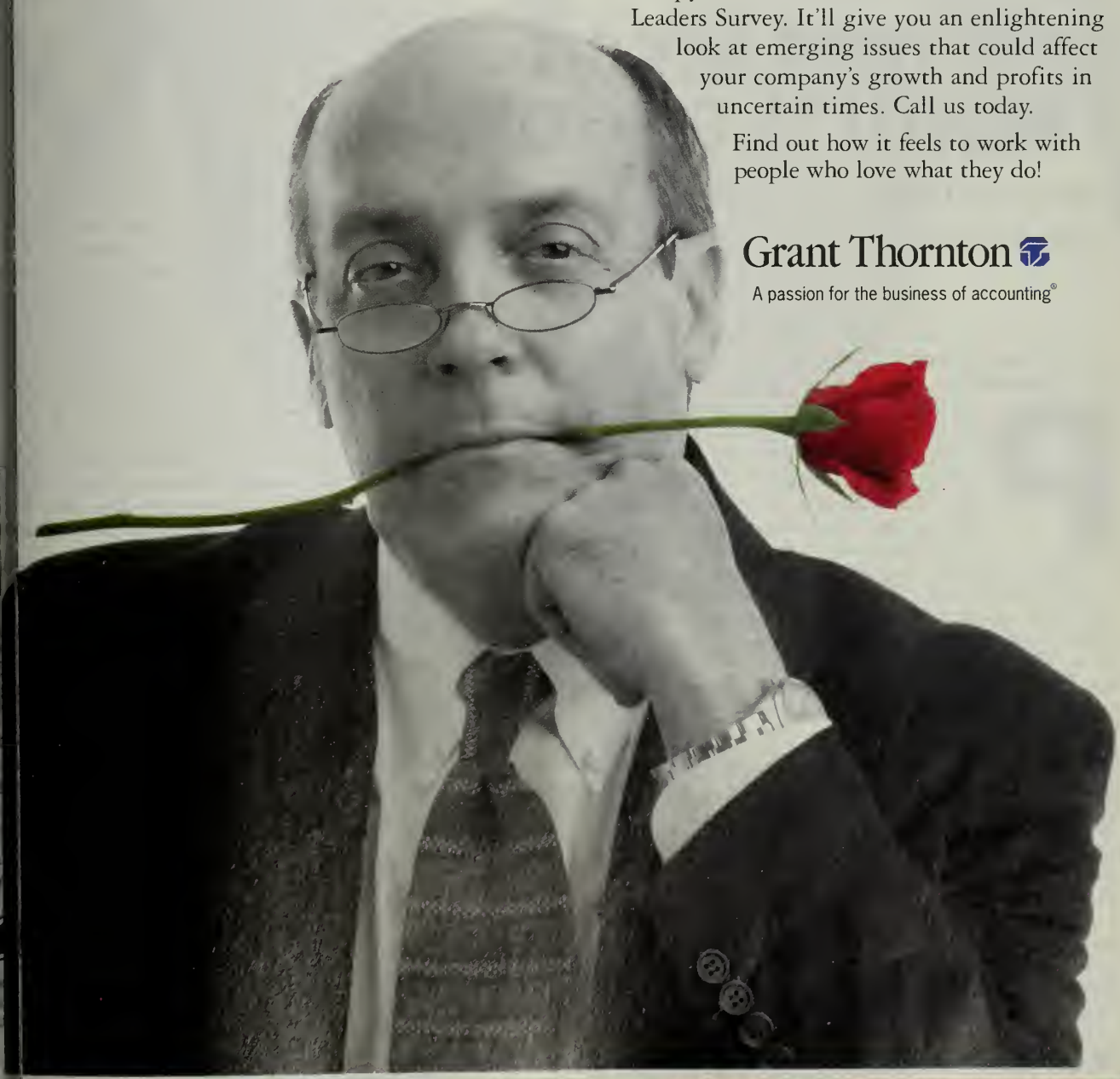

COMPUTERS

DESKTOPS ARE SO TWENTIETH CENTURY

Sure, big boxes are cheap. But laptops with names like Ferrari are all the rage

BY JAY GREENE AND CLIFF EDWARDS

PITY THE POOR DESKTOP computer. It sparked a revolution 25 years ago, but these days most consumers get about as excited by their home PC as they do by a lawn mower.

Contrast that with the passion people bring to their laptops. Thanks to plunging prices, even budget-minded road warriors are flocking to sporty new notebook designs with names like Ferrari and Aurora. Manufacturers, borrowing a page from Apple Computer Inc., are decking out portable models with nifty touches. Hewlett-Packard Co.'s Imprint Finish lets users personalize the look of a laptop cover, while Dell Inc.'s XPS M2010 folds up to look like a briefcase. "It's trendier to have a laptop," says Elizabeth Autumn, 39, a research associate with GovernanceMetrics International who tapped away on a Toshiba in a New York Starbucks one recent afternoon. "Smaller is cuter and more manageable; I carry it around like it's my baby."

With overall PC sales expected to slow sharply next year, the biggest action is shifting to the smallest machines. Just look at the numbers. Current Analysis, a research firm that tracks PC sales, found that revenue from laptop sales at major retailers it surveyed climbed 25% in the week that ended Nov. 25 from the same week the year before. Consumers seized deals such as the ones offered on Black Friday, the busiest shopping day of the year, at three of the biggest computer chains—Best Buy, Circuit City, and CompUSA. They advertised notebooks for under $400.

And desktop PCs? In the same week, desktop sales fell 2%. The actual number of desktops sold in the year throu October dropped 5%, according researcher NPD Group Inc. N book shipments were up 35% d ing that period. "Desktops are trouble," says Samir Bhavnani, search director at Current Analy "They are going to get marginali to the very high end and the very l end of the market."

Think of the desktop mar as gamers and grandmas. gamers remain a lucrative m ket segment, buying expens computers to better blast ali in head-to-head online comp tion. The elderly and all oth who simply want to read e-m and hit the occasional Web s are generally content with low-c limited-function desktops.

Analysts don't expect a big sales bo from the pending release of Windo Vista, the operating system from I crosoft Corp. After many delays, Vis consumer version becomes available Jan. 30. But most consumers don't e realize that Vista is pending, and som Microsoft's partners believe it will t well into 2007 for significant sales register. Worldwide shipments of PC desktop and notebooks—are expecte grow only 8% next year, to 230 mill units, vs. the 15% annual pace of the p three years, according to researcher I

The shift in buying patterns ma sense if you think about how people computers. Many households in de oped countries now own two or th But even in hot markets such as Ch and India, notebook growth outpa that of desktops: In Asia, shipme leaped 38% from the previous year, 9.7% for desktops.

In some ways, the shift to laptop welcome news for computer makers. L squeezed by desktops' shrinking marg they have a bit more breathing room w laptops. Notebooks deliver net profit m gins of about 8%, twice that of deskt What's more, consumers tend to repl laptops with greater frequency, buyin new one every three years compared w the nearly five it takes to ditch a desktop

Who might suffer? The folks w make accessories such as keyboards monitors, for one. There's not much n for them with a laptop. Some periphe makers, such as Logitech, already h expanded their product lines in re years to insulate themselves. Aside f gamers and grannies, it seems no wants to get tied to the desktop. ■

–With Sonal Rupani in New Y

Desktop Doldrums

Unit sales for Nov. '05 through Oct. '06

-5%	+35%
Sales drop for desktop computers	Sales gain for notebook computers

Data: NPD Group/Consumer Panel Tracking

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SPORTS BIZ

FIRST AND TEN FOR A TV UPSTART

CSTV challenges the big leaguers in college sports with games on the Web, too

BY RON GROVER

TOP COLLEGE TEAMS MAY be gearing up for the bowl season, but in the race to bring more sports to American homes, College Sports Television is the scrappy upstart to watch as it battles to play on the same field as ESPN and Fox Sports.

Four-year-old CSTV is harnessing the tribal enthusiasm people have for their favorite college teams to build the first mainstream channel with as many games on the Web as on TV. And with cable and satellite operators jealously guarding the space they give to new channels, CSTV, owned since last year by CBS, is quietly building an audience that may give it the heft to compete for the rights to premium events.

CSTV already has the rights to such big-time sports as football from Navy and other smaller conferences. But for the most part, it offers decidedly niche fare—swim meets, women's volleyball, soccer—that will never build a national audience but is calculated to hook local enthusiasts. "Our game plan," says CSTV President and Chief Executive Brian T. Bedol, "is to serve the unserved college sports fan who isn't getting what they want from ESPN or Fox."

He's talking about guys like Ryan M. Knab, New York sales manager for champagne maker Moët Hennessy USA. A Los Angeles native, Knab misses games from University of Southern California and watches CSTV on DirecTV or his laptop whenever he travels. And talk about tribal: Knab can't get enough coaches' press conferences, especially from Notre Dame's Charlie Weis and USC's Pete Carroll.

Despite fans like Knab, CSTV isn't about to mow down ESPN. Yes, the channel has nearly doubled its TV subscribers since last year. But the upstart is seen in only 15 million cable and satellite homes, vs. 90 million for ESPN. CSTV charges $14.95 a month for all-you-can watch Web streams and collects about 18¢ a month from each TV subscriber. But it won't disclose financial numbers, and Bedol says he needs about 30 million TV subscribers to break even.

Then again, CSTV has a formidable competitor in Bedol. He's the man who co-founded Classic Sports Network, which shows old sports clips, and sold it to ESPN in 1997 for nearly $200 million. And 18 months after CSTV's first telecast in early 2003, Bedol went toe-to-toe with ESPN, paying $82 million over s years to snatch away the rights for g from the Mountain West confer Bedol helped defray the costs by se some of the games to a Comcast-ov channel called Versus and by form joint venture with the cable giant to regional sports channel, called The that carries the conference's games.

'NOT GOING ANYWHERE'

AND TO GET MORE eyeballs than was offering, in August Bedol laun more than 100 broadband channels feed a network of sports sites that operates for 250 colleges around U.S. Students logging onto a sch intranet can click a sports button an wall-to-wall CSTV coverage of coa press conferences, pep rallies, and events. CSTV makes money by ing ads and getting a c merchandise sold or sites.

Bedol's dealma appealed to CBS's toriously compet CEO, Leslie Moon who also hungere take on ESPN. "It matched perfectly our own college sports deals," he Moonves aims to use CBS's muscle cable to boost CSTV's subscribers, Bedol intends to bid for more confer games to entice even more cable gu sign on.

Should ESPN and Fox be watc their backs? Both college sports TV c nels, ESPNU and Fox lege Sports (FCS), but ESPNU streams ga "We've got ESPN, most popular site. W got the rights to far r major sports," says B Magnus, vice-presi and general manage ESPNU. "They can tr get more rights, but w not going anywhe For Bedol and CSTV, means it's game time.

NOTRE DAME VS. AIR FORCE Only CSTV aired this game

THE STAT

College sports TV: The main players

Channel	Subscribers (millions)
CSTV	15
ESPNU	8
FCS	4

Data: Kagan Research, *BusinessWeek*

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RUSSIA

RUSSIA: HOW LONG CAN THE FUN LAST?

Consumers are flush. Foreign investment is up. Then there's the government interference—and corruption

BY JASON BUSH

IN MANY COUNTRIES, A LEADER with the scandal-tarred record of Russian President Vladimir Putin would be long gone. There was his ham-fisted handling of hostage crises in Moscow and the southern town of Beslan, his meddling in elections in Ukraine, and his persecution of former Yukos oil chief Mikhail Khodorkovsky. Now add to those misadventures the deathbed allegation by former KGB spy Alexander Litvinenko that Putin ordered his poisoning.

Yet in Russia, Putin remains a hero. His approval rating stands just shy of 80%, in large part because the economy has flowered during his term in a way that would have seemed unimaginable during the crisis-ridden 1990s. Growth in gross domestic product has averaged 7% per year during that period, while real incomes have climbed at more than 8% annually. Putin "is quite tough both inside and out of Russia, which is needed," says finance student Kim Volodzanin, busy shopping at an outlet of British department store Marks & Spencer in Moscow.

MOSCOW Shoppers are in a buoyant mood

SOARING STOCKS

AMONG FOREIGN investors, too, Russia has never been more popular, as the stock market is up tenfold under Putin. And some $17 billion in foreign direct investment has come in this year, roughly 75% of it in sectors other than oil and gas—an encouraging sign of economic diversification. The likes of Dutch brewer Heineken and Swedish retailer IKEA are

ving fast. More than a dozen car-
ers, including Ford, General Motors,
Toyota, are setting up or expanding
ations in Russia. And Citibank this
nearly doubled its branches in the
ntry, to 47, and says its Russian busi-
is growing at 70% annually.

That these investments have in com-
n is that they target Russia's middle
s. This group has grown from just
illion in 2000 to 55 million today
now accounts for some 37% of the
ulation, estimates Expert, a market
arch firm in Moscow. That's giving a
o the mood in the country. The share
ussians who think life is "not bad"
risen to 23% from just 7% in 1999,
e those who find living conditions
acceptable" has dropped to 29% from
, according to a recent poll.

hese hopeful folks are flocking to
es such as the new European Trade
ntertainment Center near Moscow's

Kiev Railway Station. For years, the site lay empty, a refuge for drunks and stray dogs, but today it's a five-story mall with some 160 shops selling imported clothes, jewelry, and cosmetics. Diners fill the cafés, and a multiplex is showing Hollywood blockbusters such as *Casino Royale*. "Life is definitely improving," says Alexander Kereev, a young musician out shopping for clothes. "People are earning more and spending more."

Western retailers like the sound of that. Zara, Nike, the Body Shop, and others are opening in the new mall. "We expect that our sales [in Moscow] will almost immediately reach the level of London or New York," says Ian Zilberkweit, who is setting up the first Moscow outlet for Le Pain Quotidien, an upmarket café and bakery chain based in Belgium.

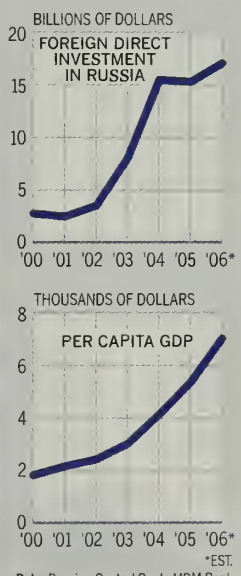
Not everyone has shared in the prosperity. Far from it. The average Russian earns $330 a month, just 10% of the U.S. average. Only a third of households own a car, and many—particularly the elderly—have been left behind. "Of course, life used to be better," says 68-year-old Yury Stepanov, who scrapes by on his state pension of $135 per month. And though new malls, offices, and apartment blocks are sprouting in second-tier cities such as St. Petersburg and Novosibirsk, there's still a gulf between the capital and the rest of the country. "The farther outside of Moscow you go, [the more the] unhappy number increases," Garry Kasparov, the chess grandmaster and a frequent critic of the Kremlin, said in an interview with Maria Bartiromo (page 158).

BUILDING UP RESERVES

SOME ALSO WONDER whether the expansion can be sustained. There's little doubt that a major driver of the newfound bounty is oil and other natural resources. Without the runup in commodity prices, economic growth would have been two to three percentage points lower during the last three years, estimates the Organization for Economic Cooperation & Development. Developing countries, meanwhile, don't have a very good track record of using windfall profits from commodity booms to lay the foundations for sustainable growth.

To his credit, Putin has used much of the cash to build up financial reserves. Russia has created a $90 billion fund—equivalent to 9% of GDP—to protect against a drop in oil prices. Fiscal policy remains tight, with the Kremlin expecting a budget surplus equal to 7% of GDP this year. And Russia is well ahead of most other resource-rich countries in its economic development, with a long tradition of education, science, and industry. Now, its tech companies are starting to give India's outsourcing sector a run for the money. Software exports will top $1.5 billion this year, vs. just $128 million in 2001. "We really can compete on a global scale," says Dmitry A. Loschinin, chief executive of Russia's largest software developer, Luxoft.

HOT GROWTH



Data: Russian Central Bank, MDM Bank

Economists warn, however, that high oil prices have bred complacency. The OECD cautions that economic reforms have largely stagnated. Worse, corruption and bureaucratic interference continue to impede business: Russia ranks alongside Gambia and the Philippines near the bottom of think tank Transparency International's annual list of corrupt countries. "It's the general scourge of Russia," says Anatoly Berestovoi, deputy director of a Moscow construction company. "You have to speed things up by interesting this or that official personally."

Most troubling is government's growing role. The Kremlin has taken control of some two dozen Russian companies since 2004, including oil assets from Sibneft and Yukos, as well as banks, newspapers, and more. Despite his sporadic support for pro-market reforms, Putin has backed national champions such as energy concerns Gazprom and Rosneft. The private sector's share of output fell from 70% to 65% last year, while state-controlled companies now represent 38% of stock market capitalization, up from 22% a year ago. "The tendency that really worries us," says William Tompson, the OECD's senior Russia economist, "is the big increase in state property."

But for now, few middle-class Russians seem to share the OECD's concerns about the economy, or the international community's worries about their president's dark reputation. ■

ADVERTISING

AMSTERDAM'S RED-HOT AD SHOPS

Its edgy, creative upstart agencies are pulling in big-name global clients

BY JACK EWING

WHEN SONY CORP. hired a new agency to handle its U.S. advertising this fall it went way beyond Madison Avenue. Instead, Sony hired 180, an upstart shop in Amsterdam. The logical reaction to moving its American work to the city of Rembrandt, canals, and legal pot might have been: "What is Sony smoking?" But in choosing 180, Sony was recognizing something big marketers such as Adidas, Ikea, and Coca-Cola already knew: Amsterdam agencies are hot. Mike Fasulo, Sony Electronics' chief marketing officer, says 180 is "full of ideas and energy, and they're not afraid to take on big challenges."

Omnicom Group knows it, too. On Nov. 30, the New York-based marketing giant said it will buy a majority stake in 180, which won the Sony business in conjunction with Omnicom's BBDO. Tucked inside a series of row houses beside a canal, 180 is one of several small Amsterdam agencies that have won global accounts by helping clients cope with a fragmented consumer market and the rise of digital media. Amsterdam "is the best place to foster an international perspective," says Chris Mendola, a 40-year-old expat New Yorker who founded 180 with two partners in 1998.

Amsterdam shops such as StrawberryFrog, 180, and the local arm of Portland (Ore.)-based Wieden + Kennedy have made their names with unconventional campaigns. For Adidas, 180 launched a World Cup-related ad blitz when French soccer superstar Zinedine Zidane stripped off his jersey after a qualifying match to reveal an undershirt that read "+10," the logo of a campaign based on the idea that a player is only as good as his 10 teammates. The campaign included buzz-generating events such as a mock World Cup featuring pickup teams chosen off the streets by star soccer players.

ALL THUMBS

AMSTERDAM AGENCIES are particularly clever at inventing quirky Net-based campaigns. StrawberryFrog, located in fashionably disheveled offices a few canals away from 180, is creating a spoof Web site to help British client Douwe Egberts launch Café Switch. The instant coffee comes in plastic pods that customers pump with their thumbs to make foam, and the site purports to let people auction ad space on their thumbs. To promote Asics' Onitsuka Tiger shoes, the agency filmed o enthusiastic Japanese teens singing gc songs in English. The shoes sold out as film spread on the Net.

Of course, every major city has agencies, and the Amsterdam shops still relatively small. What sets Ams dam apart is that these local upst are doing global work, often for A clients on the other side of the pond. Amsterdam office of Wieden + Kenn for instance, has anchored key wo wide campaigns for Coca-Cola Co. Electronic Arts Inc. And last sumr StrawberryFrog started working for V Mart's Sam's Club stores.

Why Amsterdam? The city's openr and bicycle-to-work lifestyle help att talent, as do a vibrant design scene a cosmopolitan mix of people. "Ams dam allows us to be in touch with world without being swallowed up any particular culture," says Brian liott, a founder of StrawberryFrog. hallmark of Amsterdam TV ads is litl no dialogue, so nothing gets lost in tra lation. For instance, Wieden + Kenne "happiness factory" spot, running scores of markets worldwide, conj an animated fantasy world inside a C vending machine—with no words.

Omnicom's acquisition of 180 ra the question of whether small agen founded on a rejection of the status can remain creative as they grow. Four Mendola notes that 180 has a strong cord of cooperation with big shops, inc ing Omnicom's TBWA, which co-mana the Adidas account. But crosstown Tim O'Kennedy, managing dire of Wieden + Kennedy Amsterd questions whether global ad gro can tolerate the ups and downs are part of being a small, cutting-e agency. "Do really, really g work," O'Kenr says, "is more v tile and risky t doing work th O.K."

ATTENTION The +10 campaign for Adidas got buzz during the World Cup

Move Over Mad Ave

COMPANY	CLIENTS	NOTABLE CAMPAIGN
180	Adidas, Sony, Motorola, Opel	"Impossible is nothing" for Adidas
STRAWBERRY FROG	IKEA, Panasonic, Sam's Club, MTV	*Casino Royale* tie-ins for Heineken
WIEDEN + KENNEDY	Nike Europe, Coca-Cola, Electronic Arts	"The Coke Side of Life"

Data: Ad a

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CHINA

HOW YAHOO MISSED OUT ON THE MAINLAND

In China, tough rivals and serious blunders have left the portal in turmoil

BEIJING
Yahoo needs the growing market

BY BRUCE EINHORN

IF ANY U.S. INTERNET COMPANY should have done well in China, it's Yahoo! Inc. The Net powerhouse was early to the mainland, establishing a unit there in 1999, well before most U.S. dot-com rivals. With Yahoo Japan, the company already had a big success in the region. And Yahoo co-founder Jerry Yang was born in Taiwan to a father from the mainland, making him something of a local hero.

Yet Yahoo China has suffered numerous management missteps and now trails competitors by a wide margin. The latest setback came on Nov. 27 when President Xie Wen stepped down "for personal reasons" after just 42 days on the job.

Yahoo's travails in China hurt, and not just because Yang's reputation in the mainland might be tarnished. With more than 123 million people online, China is an important growth market for any Net company. Yahoo, No. 14 on this year's *BusinessWeek 50* list of the best-performing large companies, faces challenges at home in trying to catch Google Inc. in search ads and sheer buzz. So it's important that it succeed in China.

That goal looks more elusive each day. The company got a black eye early this year when U.S. pundits and politicians pilloried it for cooperating with Chinese authorities in the arrest of a dissident who had a Yahoo China e-mail account. As a portal, Yahoo lags behind local rivals Sina.com and Sohu.com. So a year ago, Yahoo China decided to focus on search and redesigned its page with an uncluttered look similar to Google's. But after just five months, Yahoo switched back to the busier look of a portal. Today it's a distant third in search behind market leader Baidu.com. "Yahoo still hasn't made a major impact in China," says Duncan Clark, managing director of Beijing consulting firm BDA China Ltd.

THE STAT

China's search landscape*

Baidu	62%
Google	25
Yahoo	5

* First choice of search engine
Data: China Internet Network Information Center

To set things right, Yang last year transferred the China operation to Alibaba.com, which runs online auction sites in mainland. In exchange, Yahoo paid billion for a 40% stake in Alibaba. partnership has hardly been a ste success. Yang and Alibaba CEO Jack have known each other for years, industry watchers say there have b disagreements between China mana and California headquarters, and Xie shortly after he and Ma returned fro trip to the U.S. to discuss strategy. Ya declined to comment, but a spokesr for Alibaba says there haven't been nificant disputes.

SPYWARE SHENANIGANS

YAHOO CHINA ALSO faces accusati by a former executive that it spre malware, software that installs i without permission. The charges c from Zhou Hongyi, who became eral manager in 2003 when Yahoo C bought Zhou's search engine. In Aug 2005, Zhou resigned and soon lande Qihoo.com, a Net search outfit bac by U.S. venture funds such as Seq Capital. Qihoo distributes an anti-ware program identifies Yahoo na's toolbar as ware and zaps it f computers. Zhou that while he worked at Yahoo, the s egy was to distribute the toolbar wi and get users to unwittingly visit via pop-up windows. Now he cl he wants to make amends with Qih program. "I opened the Pandora's so I should do something to close Yahoo China has launched an u competition lawsuit against Zho Beijing. Zhou has filed a defamation of his own.

Despite the turmoil, there's some news. In November Y China won a suit bro by the China Confeder of Anti-Rogue Softwa local anti-malware g And Morgan Stanley lyst Richard Ji says Y China registered a increase in repeat vis over last year, vs. 3% Baidu and a drop of 2 Google. "Although its ket share is small," sa Yahoo "is very sticky."

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70%

unbending
30%

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THE BE & WORST

IT WAS A YEAR OF SURPRISES. Sure, some companies hit their targets, hewed to their strategic plans, and got their products out on schedule. But we were struck by how many of the year's business developments were unpredictable, even downright weird. Who would have dreamed that YouTube would go from startup to a $1.65 billion cash-out in 18 months? Who could have foreseen Jonathan Schwartz's turnaround at Sun Microsystems or Martha Stewart's smash alliance with KB Home during a housing bust? Or the private equi rampage—note Blackstone's recor $36 billion offer for part of Sam Ze real estate empire—or some truly dizzying mistakes, such as Sony's exploding laptop batteries?

BusinessWeek's second annual I & Worst issue will guide you throu the peaks and gulches. We begin w Leaders, from standouts like steel magnate Lakshmi Mittal to fallen t like Pfizer's Henry McKinnell. We a list of those CEOs who delivered g value to shareholders—and those

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OF 2006

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CEOs in trouble with the law.
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heralds a new era in aviation.
me? Climb on the Honda 2006
Ving, the first motorcycle with
bag. Other stars include the first
vaccine, a deluxe watch for
, and Cisco's spectacular new
nferencing system.
nally, we scope out the Ideas that blossomed to change the business world in 2006. The most striking, perhaps: getting customers to do your work for you. In the Ideas We Wish They'd Never Had Dept.: backdating options, pretexting, and the O.J. Simpson book.

This year we also add a new feature, dubbed "The Jury Is Out," covering Leaders, Products, and Ideas whose fates aren't yet clear. Will Zune give the iPod a run for its music? Can Rick Wagoner fix GM's drivetrain? Investors, place your bets.

–By Harry Maurer

—Susan Berfield (Leaders), Brian
roducts), and Michelle Conlin (Ideas)—
inessweek.com/podcast.

Watch our weekly TV show, BusinessWeek Weekend, for more on the best products of 2006. Check your local listings or go to businessweekweekend.com for details.

LEADE

The best took their companies to new heights and made investors proud. The worst? Well, check out our rogues' gallery

EDITED BY SUSAN BERFIELD

MOST GENEROUS CEO

Warren Buffett, Berkshire Hathaway

AS THE WORLD'S second-richest man and most famous investor, Warren Buffett had long said he would one day give away much of his $46 billion fortune. That day came on June 26 when Buffett announced that over the next several years he would donate Berkshire Hathaway stock totaling some $31 billion to the foundation run by his friend (and the world's richest man) Bill Gates, and Gates's wife, Melinda. Buffett, 76, said the reason for doing so was obvious: "I'm saying, 'You can give it away better than I can, so I'm turning it over to you.'" As for Buffett's three children, who also control foundations, he's giving them about $3 billion altogether.

BEST START AT A NEW COMPANY

Jim McNerney, Boeing

TWO CHIEF executives in two years left Boeing under dark clouds of scandal. Then in July, 2005, came W. James McNerney, the former 3M boss who was once a contender to replace Jack Welch at General Electric. He is known as an astute manager, a strategic thinker, and a self-effacing leader, which turns out to be just what Boeing needed. On the defense side of the business, McNerney, 57, has helped clean up a management culture tarnished by ethical improprieties and injected some urgency into a division that struggled to keep key Pentagon contracts. Boeing won a bid, which could be worth as much as $15 billion, to supply the U.S. Air Force with modified Vietnam-era Chinook helicopters. Note that McNerney didn't try to sell the military the most complicated and expensive helicopter Boeing could devise. When it came to dealing with the commercial airplane division, McNerney wisely backed the project under way: the fuel-sipping carbon-fiber 787 Dreamliner. He says the first planes, due in 2008, will be on time and on budget.

MATTHEW GILSON; ILLUSTRATION BY LARA TOMLIN

BEST ANSWER TO GOOGLE

Robin Li, Baidu

BILL GATES AND STEVE Ballmer might want to have a sit-down with Chinese entrepreneur Robin Li. The founder and CEO of Chinese search engine Baidu.com has achieved something that Microsoft's top brass have yet to manage—beating Google. By far China's No. 1 search engine, Baidu has a 62% market share, more than double Google's. And Baidu widened its lead

over the Americans in 2006, despite Google's efforts to boost its China operation. Li, 38, has had his problems, including lawsuits alleging Baidu's involvement in click-fraud. But Baidu denies wrongdoing. Its NASDAQ-listed stock is up over 80% this year.

BEST JUGGERNAUT

Eric Schmidt, Google;
YouTube founders **Chad Hurley** and **Steve Chen**

CAN LIFE GET any better for Google? Buoyed by better-than-expected third-quarter earnings, which increased 92% on $2.7 billion in revenues from its search ads, the stock briefly topped a head-spinning $500 a share in late November. Even after a measure of calm returned, the search giant's market cap stands at more than $147 billion, equal to, oh, almost nine times that of General Motors. Credit Google's triumvirate leadership of founders Sergey Brin and Larry Page and CEO Eric Schmidt, who have managed to beat back rivals from Yahoo! to Microsoft. So far, investors have been strangely trusting that Google's far-ranging initiatives will someh all fit together.

Google's outsize a tions did become mu clearer in October, wh it bought the runaway hit video site YouTube $1.65 billion. Co-four in February, 2005, by Chad Hurley, Steve C and Jawed Karim— friends from the onlir payment service Pay

YouTube's Hurley and Chen. Google's Schmidt (below)

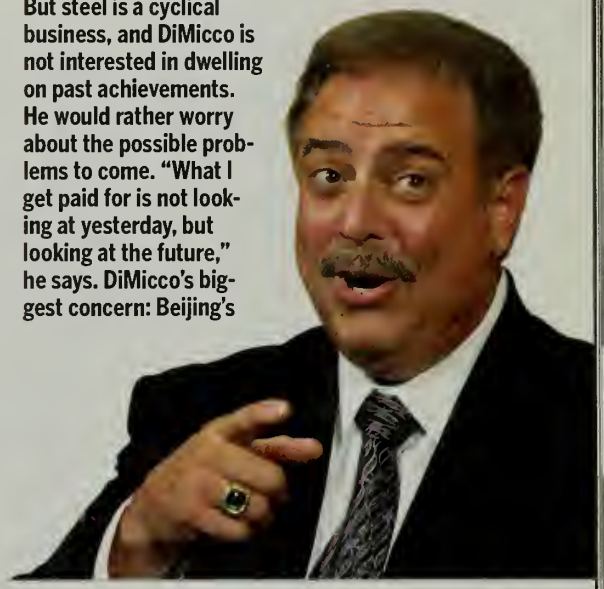
be has become the most popular Web t now attracts 81 on monthly visitors collec- of wacky eur s—as as il- y posted from rams as *The Show* *Jon Stewart* and *The sons*. Equity stakes evenue-sharing offered to music elevision companies quieted complaints about such piracy, but Google has nevertheless set aside several hundred million dollars to fight potential lawsuits.

Still, piracy may soon be the least of Big Media's concerns. With Google's recent test of print ads with 50 big newspapers, the secret is out: Google aims to become the vortex of all modern advertising.

MOST INSPIRING STEEL BOSS

Dan DiMicco, Nucor

GOOD LUCK trying to give Dan DiMicco a compliment. True, the 56-year-old CEO of steel giant Nucor should have every reason to crow these days. Nucor's stock is up 95% in the past 12 months thanks to hot steel demand, high-grade profitability, and well-performing acquisitions. In the first nine months of 2006 the company earned more—$1.35 billion on $11.3 billion of sales—than it did in all of 2005. And 2005 itself had been a record year. But steel is a cyclical business, and DiMicco is not interested in dwelling on past achievements. He would rather worry about the possible problems to come. "What I get paid for is not looking at yesterday, but looking at the future," he says. DiMicco's biggest concern: Beijing's subsidizing of its own steel industry. The 23-year Nucor veteran, who has been boss for the past six, is more than happy, though, to dole out praise to all those he calls his teammates. Even as Nucor has grown to 11,600 employees (only 66 of them in the Charlotte headquarters), DiMicco has continued the practice of putting everyone's name on the front and, now, the back covers of the company's annual report.



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MOST DRAMATIC HANDOVER

Bill Ford to **Alan Mulally,** Ford

IT WAS ALMOST operatic enough to be set to music. William Clay "Bill" Ford Jr. realized this past May that he was in over his head as chairman and CEO of his family's company, which has been stuck in neutral since he swooped in to fix it in October, 2001. He told his board in July. Involved in the search for his replacement were such high-profile board members as John Thornton and Richard Gephardt, the former Majority Leader in the House of Representatives.

They found Alan Mulally (right), then Boeing's head of commercial airplanes, who had been passed over for the CEO job twice. Mulally, 61, is a confirmed Lexus fan. He is also a devotee of Toyota Motor's manufacturing and engineering systems. Ford wanted an outsider to bust up the company's dysfunctional culture, not a hotshot auto industry insider. Ford Motor's iconic status trains more eyes on its travails than a typical company in turnaround mode. If he succeeds, Mulally will be a hero. If not, Bill Ford will get the blame for choosing badly and cracking up his great-grandfather's legacy. Seems fair.

MOST HEAD-TURNING HANDOVER

Allen Andreas to **Patricia Woertz,** ADM

PATRICIA A. WOERTZ 53, used to be all about Big Oil. At Chevron, where she worked for 29 years, she rose to become executive vice-president for refining and marketing. But what she really wanted was to be a CEO, and when that didn't seem possible at Chevron she started looking elsewhere. Elsewhere turned out to be Archer Daniels Midland, a $36 billion Decatur (Ill.) company that is the country's biggest producer of ethanol, the alternative fuel that oil executives love to denigrate. Woertz is the first outside the Andreas family to run ADM since 1970. (Allen Andreas is chairman.) Now she consults with the environmentalist Vinod Khosla, talks about biodegradable plastic, and has proclaimed that we are in a "new era of bioenergy."

SMOOTHEST HANDOVER

Steve Reinemund to **Indra Nooyi,** Pepsi

SHE COULD HAVE been a controversial choice. An India-born woman with a penchant for straight talk, wry humor, and singing in the halls took over from a former U.S. Marine who shied away from the public eye. But the transition in October from Steven S. Reinemund to Indra K. Nooyi at the $33 billion PepsiCo was noticeably angst-free. One reason is that Nooyi, 51, has been a central force behind the company's recent stellar performance, helping to orchestrate major acquisitions such as Quaker. As a former chief financial officer and president of PepsiCo, she knows the culture. And Nooyi's ascension didn't spark an exodus of other top talent. But smooth handover does mean it's business as usual. Nooyi is most interested in the comp going truly global and ting into healthier food She is under intense s tiny, but Nooyi is comf able in the spotlight.

(TOP TO BOTTOM) AARON HARRIS/CANADIAN PRESS/AP PHOTO; KRISTEN SCHMID SCHURTER/*THE NEW YORK TIMES*/REDUX; PEPSICO INC./BLOOMBERG NEWS

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MOST UNLIKELY TURNAROUND

Jonathan Schwartz, Sun Microsystems

EVER SINCE THE dot-com bust, Sun Microsystems has replaced Apple Computer as Silicon Valley's lovable loser: a software company admired for its innovations and scrappy corporate culture but somehow destined to lose out against bland giants such as Hewlett-Packard and IBM. And when 41-year-old Jonathan Schwartz was named CEO in April, many critics figured the odds of a turnaround got longer still. At that point, Schwartz's major claims to fame were his geeky brilliance and well-read blog. Lo and behold, Schwartz is starting to prove the naysayers wrong. Since July the stock has risen some 40%, as Wall Street has come to have more faith in major planks of Schwartz's plan. Losses have declined thanks to steep cost-cutting and improved sales of key products, and Schwartz is starting to win over skeptics with his longer-term plan to lift margins back into double-digit territory. He's even being taken seriously on the larger stage: Washington took note when he proposed that companies be able to use their blogs to disseminate sensitive financial information now covered by federal disclosure rules.

The Jury is Out

Brenda Barnes, Sara Lee

Brenda Barnes, 53, rejoined the workforce two years ago as head of Sara Lee, a company that in some ways seemed frozen in time. She has tried to get things going again by selling or spinning off brands and centralizing the company's far-flung operations. But she hasn't been able to produce strong and consistent earnings growth. High-profile brands like Jimmy Dean just aren't doing it for the company. Barnes needs to find some innovative and tasty new products for Sara Lee, and fast.

Rick Wagoner, General Motors

General Motors Chairman G. Richard Wagoner Jr. has surprised recently: He eked out a profit after losing $10.6 billion last year, which was enough to ward off billionaire investor Kirk Kerkorian, who had posed a challenge to Wagoner's leadership but then dumped his 9.9% stake in GM. The company, however, is still burning cash and losing market share at home. Wagoner, 53, plans to make real money by seeking more union concessions and, yes, producing a few hit cars.

Michael Cherkasky, Marsh & McLennan

After two years as head of troubled Marsh & McLennan, Michael G. Cherkasky, 56, finally had a good quarter. Credit savings from layoffs totaling 5,750 jobs, and increasing cooperation among insurance brokers at Marsh, human resource consultants at Mercer, and corporate sleuths at Kroll. Now he has to keep private-equity giants from swooping in with a buyout that would likely bust up the outfit. That means boosting MMC's stock, which has fallen 43% since 2003.

Jennifer Elias and Julie Tucker, Founders, SmartsCo

On a wintry night last year, SmartsCo, a publisher of party games, received a frantic call. A retailer needed stock overnight for a holiday event. So Jen and Julie packed their cars and hand-delivered it. "Likewise," says Jen, "when we sorely needed better cash flow, American Express cared enough to make sure we got it."

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Disciples of the Simpler Life

Foodies criticize **Rachael Ray** for her shortcuts, her ingredients (some canned!), and her distinctly irreverent tone on her four Food Network cooking shows. Martha Stewart says she hasn't learned a thing from Ray's syndicated talk show, which went live in September, had the highest rated premiere since Dr. Phil, and is backed by Oprah Winfrey. Ray, who is 38 and invariably described as perky, offers a beguiling promise to millions of time-pressed Americans. Cooking at home can be easy, fast, and cheap. She stands in obvious contrast to you-know-who. In addition to Ray's television shows, where she first introduced the idea of *30 Minute Meals*, she has written 13 books, edits a monthly magazine that is published by Reader's Digest, has expanded a line of cookware, and, perhaps at the suggestion of an overly eager music executive, put her name on a compilation of her favorite holiday songs.

RAY has five TV shows on the go

The business that **Scott Griffith,** 47, runs began six years ago with a simple premise. A lot of urbanites don't want the hassle of owning a car, though often enough they'd like to have one for an hour or two. Zipcar, which is the largest car-sharing operation in the U.S., has 2,500 vehicles in seven metropolitan areas. Members receive an electronic pass that opens the door of the car they've reserved, which is parked near their work or home. The keys are inside, and there's gas in the tank. Zipcar has some 80,000 members; Griffith says about 40% of them chose to sell their cars or put off buying one because of Zipcar. The business is both green and growing (revenue should double this year, as it has in the past three), so naturally it has attracted the money folk. In May a unit of General Electric gave the Cambridge (Mass.) company $20 million in lease financing; in November, Zipcar received $25 million from several private-equity firms.

GRIFFITH says many Zipcar users opt out of owning a car

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BEST MOBILE MOGUL

Wang Jianzhou, China Mobile

WANG JIANZHOU, 58, leads a telecommunications company that will soon have a subscriber base (300 million) that is as large as the entire U.S. population. Hong Kong-listed China Mobile is already one of the world's most valuable telecom companies, with a market cap of more than $160 billion. Wang's initiatives target everyone from rural residents to Rupert Murdoch. In October, the company launched an Internet and short-message service providing crop-price data to farmers. Just weeks later, China Mobile announced a deal to launch a wireless music service in partnership with Murdoch's News Corp. That followed its $166 million purchase in June of a 19.9% stake in Murdoch's Phoenix Satellite Television Holdings, which has a popular 24-hour news channel in China. And if all that weren't enough, Wang is also looking to establish the company overseas, particularly in developing countries.

BEST FAMILY-RUN BUSINESS

Lakshmi Mittal, Arcelor Mitt

LAKSHMI N. MITTAL, the India-born steel king, made concessions to win his brutal takeover battle for the world's No. 2 steelmaker, Luxembourg-based Arcelor, in July. One was the higher-than-expected $38 billion price. Another was ceding the CEO role at the new company, Arcelor Mittal, to Arcelor executive Roland Junck. That arrangement lasted only until Nov. 6, when Junck stepped aside in favor of Mittal, 56. Junck will remain an adviser. The Mittal family, which has 43.5% of Arcelor Mittal, is once again firmly in control. Mittal's son Aditya, 31, was ensconced as chief financial officer soon after the acquisition. Now Mittal can really bring his entrepreneurial spirit to bear at Arce which had more tha share of bureaucrac "We are trying to ch the culture," he said a recent interview. " decisions swiftly, tal risks, move forward.

It's hard to argue such family control a bad thing when yo look at Mittal's track record. In less than decades he has buil global steel empire scratch and made h self a fortune of mo than $20 billion. His company will produ three and a half tim much steel per year its nearest competit Nippon Steel. It also highly profitable. Lo don broker Cazenov forecasts that Arcel Mittal will earn billion in pret profits this on revenu $82.7 bil

Executives: Bang for The Buck

These are some of the bosses whose companies performed well but whose pay was relatively modest. Then there are those who were richly rewarded even though investors weren't

	BEST VALUE*			
	Richard A. Packer Zoll Medical	David G. Whalen A.T. Cross	Sandra B. Cochran Books-A-Million	Garry O. Ridge WD-40
PAY	$530,019	$536,800	$923,112	$691,116
TOTAL RETURN	99.4%	99.7%	125.8%	21.6%
	WORST VALUE*			
	Terry S. Semel Yahoo!	Don L. Blankenship Massey Energy	Robert L. Nardelli Home Depot	Gary D. Forsee Sprint Nextel
PAY	$53.3 Million	$32.6 Million	$35.8 Million	$26.9 Million
TOTAL RETURN	-32.9%	-27.1%	-7.5%	-13.5%

* Based on the total return of the company from 11/30/05 to 11/30/06 compared to CEO pay as listed in the most recent proxy. Total return is calculated using the change in share price plus dividends (after the dividends have been reinvested into the company stock). Total compensation comprises: salary, bonus, total value of restricted stock granted, total value of stock options granted (using Black-Scholes), long-term incentive payouts, and all other compensation. For the best-value execs, we considered only those whose stock performance exceeded the S&P 500's 14.2% growth. And for the worst, only those whose stock grew less than that.

Data: Standard & Poor's ExecuCom

DOUBLE POINTS EARNED FROM BUSINESS PURCHASES:

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Sheet pans ..... 1,600 pts
Refrigerator ..... 56,000 pts

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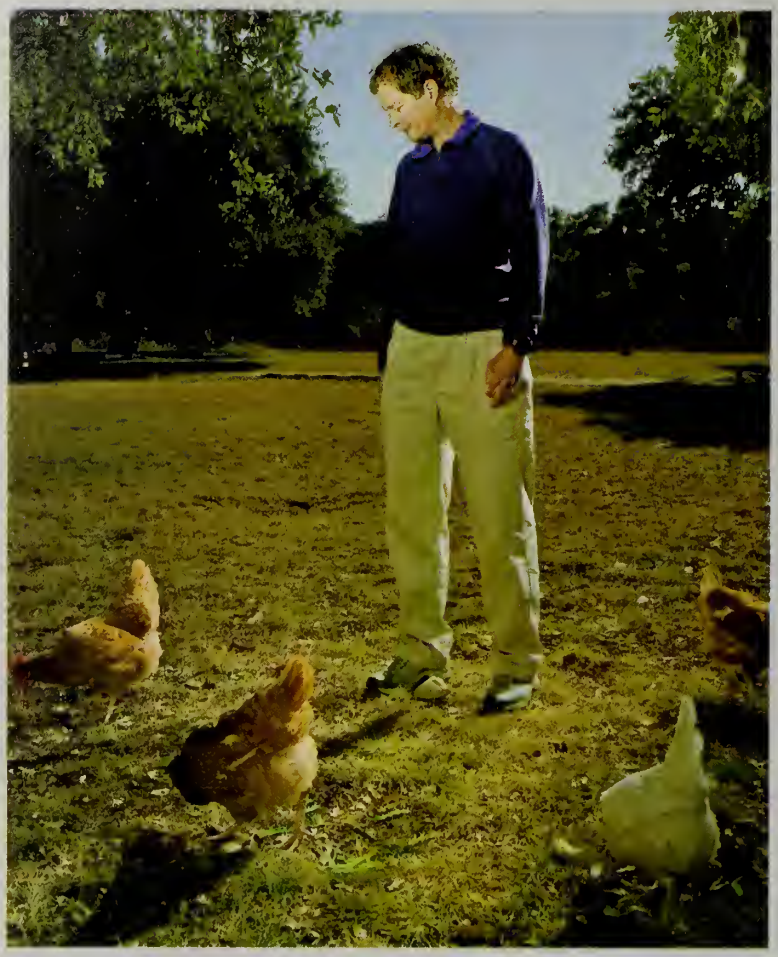
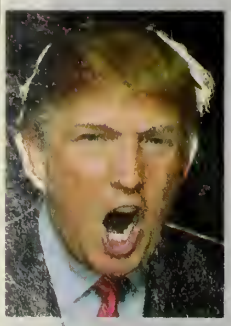


Biggest Reality Bite

Perhaps living with the nickname "Whole Paycheck" took a toll. Or maybe consumers found they could get organic pomegranate juice and sesame-encrusted tuna at their local grocery store. Whatever the reason, 2006 was the year that **John Mackey's** Whole Foods Market chain fell to earth. The days of ringing in 15% same-store sales growth and cashing in on a dizzying stock price are over: The Austin (Tex.)-based grocer now seems a whole lot more ordinary. Annual sales growth fell into the single-digit range for the first time this year, and the stock price has dropped by a third over the past year. Mackey may be partly to blame for allowing the company to expand too fast over too short a period. But the real problem seems to be that reality is starting to bite. The 52-year-old Mackey called the previous three years of growth an "aberration." And with chains like Wal-Mart Stores getting into the organic food game, Whole Foods will be facing stiff competition on a scale Mackey may not have seen coming.

Most Difficult to Please

Nike co-founder **Phil Knight,** 68, wanted an outsider to stir up the company's notoriously insular culture, so he hired William Perez from S.C. Johnson & Son in late 2004. Thirteen months later he forced Perez to resign, saying the chief executive had failed to "wrap his arms around" Nike's culture. Knight promoted a company veteran to the job, and Perez, 59, went on to run William Wrigley Jr.



Donald Trump, 60, fired his *Apprentice* sidekick, 37-year-old Carolyn Kepcher, as chief operating officer of Trump National Golf Clubs because she was trying, apparently with some success, to make a name for herself. As he said: "I don't need stars. I need people who run property."

Ronald Perelman, the chairman and majority shareholder at Revlon, has gone through two chief executives in six years (and four wives over a much longer period of time). No one, including most recently Jack Stahl, has been able to beautify a company struggling with $1.4 billion in debt while facing off against better-financed and more au courant rivals. The 53-year-old Stahl, who joined Revlon from Coca-Cola, lasted four years on the job. Actress Ellen Barkin, on the other hand—the latest ex—was married to Perelman, 63, for almost six.

First, **Sumner Redstone,** the very active octogenarian still leading Viacom, fired and humiliated box office star Tom Cruise by saying he was overpriced and behaving badly. Then Redstone ousted Tom Freston, his chief executive officer and heir apparent, because, among other missteps, Freston lost MySpace to Rupert Murdoch. Now Redstone seems to be at odds with daughter and employee, Shari, too.

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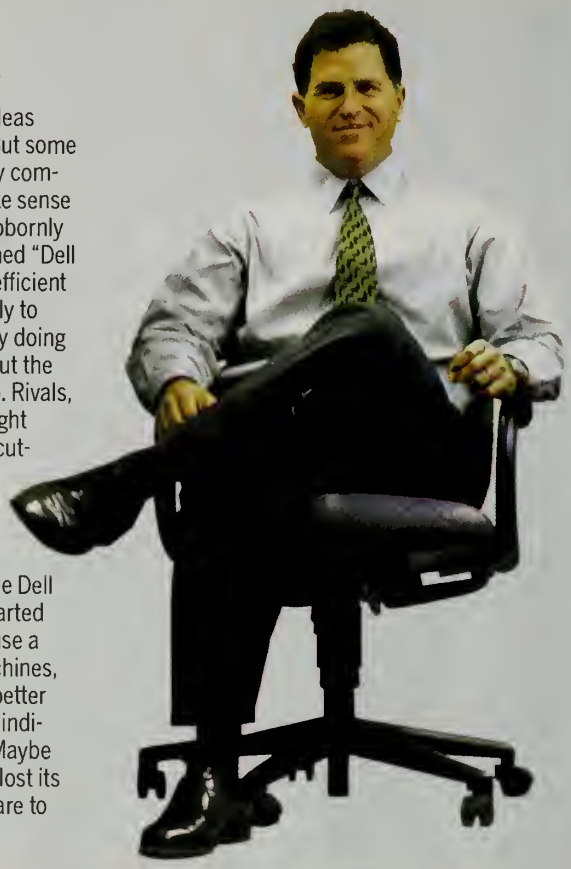
Worst Reaction Time

Michael Dell, 41, had a few great ideas about how to run a PC company. But some have been successfully adopted by competitors, and others just don't make sense anymore. Dell, though, seems stubbornly resistant to change. Under the famed "Dell Way," the company used an ultra-efficient manufacturing system, sold directly to customers, and held down costs by doing little research and development. But the model began to crack in mid-2005. Rivals, in particular Hewlett-Packard, caught on. Customers began demanding cutting-edge products and better service. As sales growth rates and margins took a dive and the stock fell 18% through the first 10 months of the year, Dell stuck to the Dell Way. Recently the company has started to improve customer service and use a wider variety of chips in some machines, and its third-quarter results were better than expected. But Dell still hasn't indicated he's up for bigger changes. Maybe this will change his mind: Dell just lost its long-held No. 1 perch in market share to Hewlett-Packard.



Worst Talent Manager

Executives leave companies all the time, right? But Gap CEO Paul Pressler, 49, seems to be watching an unusually high number of top people head for the door. In 2006 at least 10 senior executives left the giant clothier, and the only good thing to say about the exodus is that at least it's not as big as the one in 2003, the year after Pressler took the helm. Among the departures this year were the heads of the international and supply-chain areas, merchandising executives, and the long-time chief of Gap's Old Navy chain. Some have gone on to big jobs at high-profile brands, including Lands' End and Bath & Body Works.

So if it's not them, then chances are it's him. Pressler has cleaned up Gap's balance sheet by cutting costs, but many don't think he actually gets fashion. The company's sales and profits have been falling for more than two years. Gap responds that "it is commonplace in turnaround situations to see significant changes made in senior executive ranks."

Pink Slips In the C-Suite

WILLIAM McGUIRE, UNITEDHEALTH GROUP

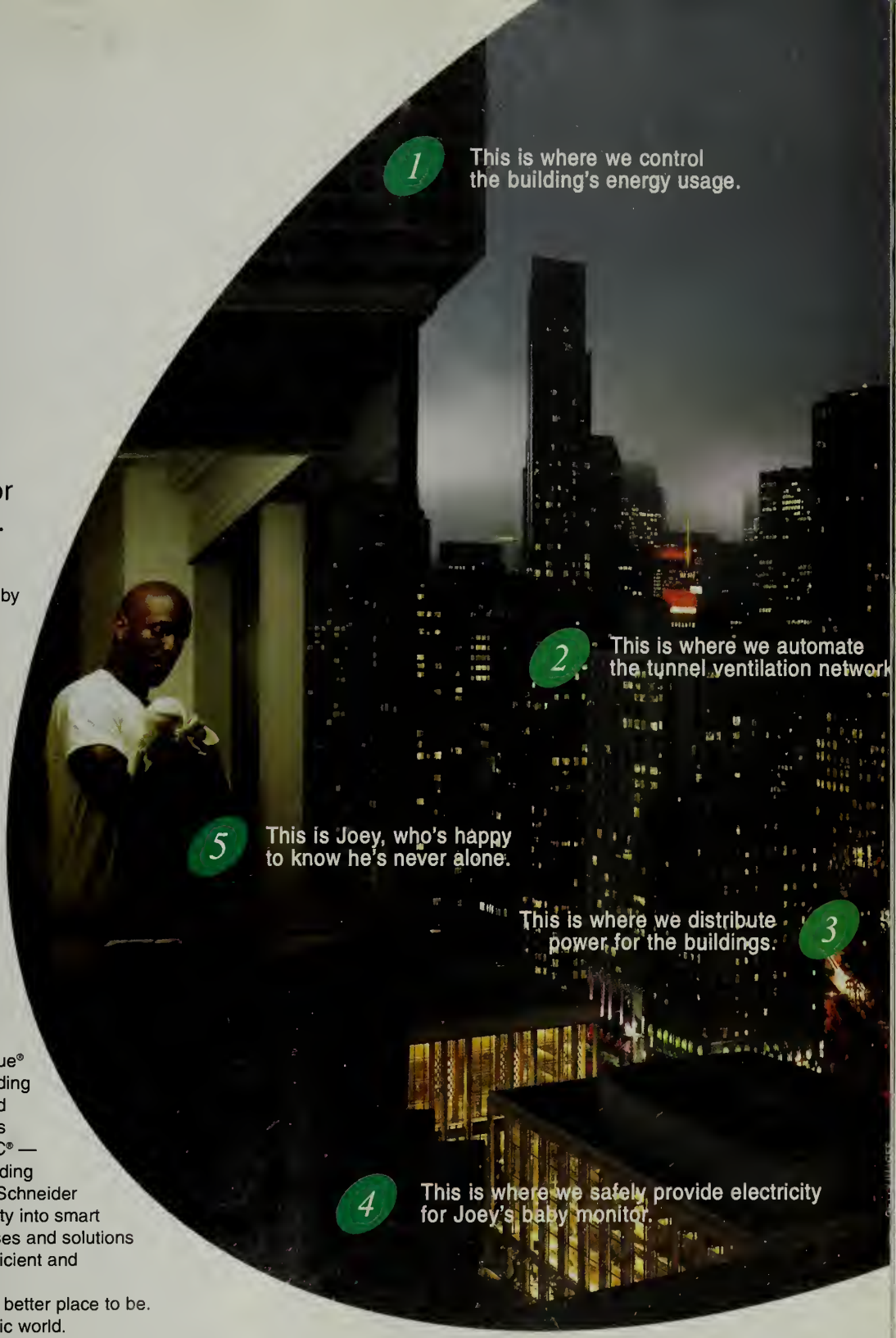
Greed felled William McGuire, 58, the physician who built UnitedHealth Group into a $70 billion-a-year titan over 15 years. He was forced out over alleged backdating of stock options that at one point were worth $1.78 billion. McGuire denies the claims against him.

HENRY McKINNELL, PFIZER

Henry A. "Hank" McKinnell Jr., 63, was expected to retire from Pfizer in 2008. This summer the board decided it couldn't wait. Under McKinnell, Pfizer failed to find replacements for older drugs such as the antidepressant Zoloft, which lost its patent protection in June. Low-cost alternatives are threatening Lipitor, its $12 billion-a-year cholesterol drug. In late November, Pfizer announced it would lay off 20% of its salesforce. A few days later it had to stop all trials of the highly anticipated cholesterol treatment torcetrapib.

NOEL FORGEARD, EADS

Noël Forgeard lost his job as co-chief of Airbus parent European Aeronautics Defence & Space in July over production snafus on the 550-plus passenger A380 jet. The problems cost Airbus two years and $6 billion, plus its hopes of edging out its eternal rival, Boeing.



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Most Buyer's Remorse

Shortly after Boston Scientific CEO **James R. Tobin,** 61, engineered a $27 billion acquisition of Guidant in March, the purchase started to look like a horrible mistake. The overall market for Guidant's main product, implantable cardioverter defibrillators, began to fall after growing 20% a year. Analysts blamed Guidant: Its string of quality-related product recalls likely caused cardiac patients and their physicians to lose confidence in its brand name. As if that weren't enough to give Tobin palpitations, safety concerns cropped up over Boston Scientific's other important product, drug-coated stents. This year the company lost about 40% of its shareholder value. "We have every confidence that over time we will realize the growth, diversification, and other benefits of this deal," a company spokesman says.

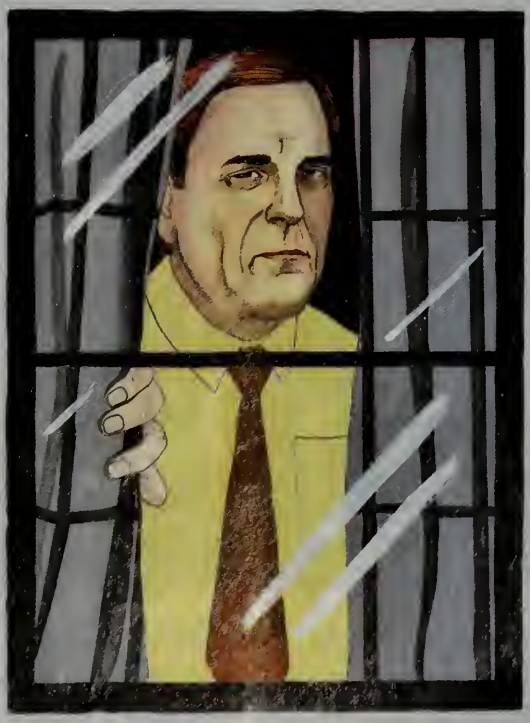
Worst Twilight Years

Lord John Browne rescued BP from financial difficulty in the early 1990s and built it into one of the world's top oil players. But the twilight of his career as CEO of the London company is proving difficult for the man long considered the industry pacesetter. Over the past 18 months, BP and Browne have been hammered by a series of mishaps in the U.S., beginning with an explosion at the company's Texas City (Tex.) refinery in March, 2005, that killed 15 people and injured about 170. BP has admitted responsibility for the accident and set aside $1.6 billion to compensate victims and their families. BP's shutdown of half of its premier Alaskan Prudhoe Bay field in August to fix bacteria-corroded pipes also dimmed the company's reputation and that of its CEO. Adding to these woes, the U.S. Commodity Futures Trading Commission announced a civil suit alleging BP fixed prices in the propane market. U.S. regulators also are investigating other aspects of BP's aggressive oil and gas trading.

Corporate Justice

"AS THE MANY VICTIMS have so eloquently testified, his crimes have imposed on hundreds, if not thousands, a life sentence of poverty," said U.S. District Court Judge Simeon Lake III in October as he condemned former Enron Chief Executive **Jeffrey Skilling,** 53, to 24 years in prison and ordered the unrepentant ex-boss to pay $45 million to Enron shareholders. Skilling, convicted months earlier on 19 of 28 counts of conspiracy, fraud, lying to auditors, and insider trading, plans to appeal his guilty verdict.

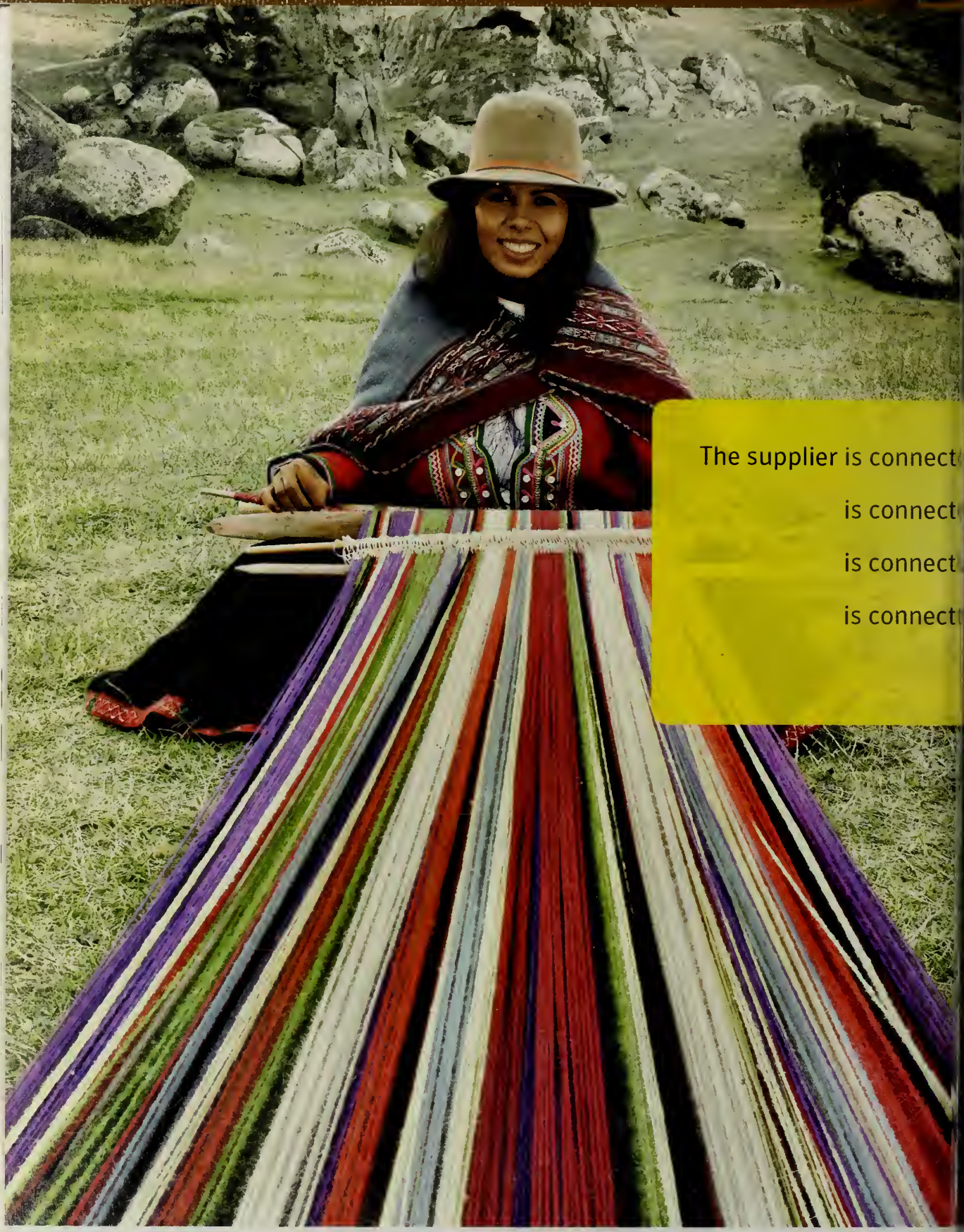
Skilling's legal fees so far have come to an astonishing $70 million. Attorney Daniel Petrocelli tried to get the judge to award him the $30 million still owed from Skilling's estate. He got about half that. Lake also voided the conviction against **Kenneth Lay,** the former Enron chairman, who died of a heart attack in July.



The main witness in the case against both Skilling and Lay, former Chief Financial Officer **Andrew Fastow,** who is turning 45, will spend six years in prison. He's trying to help shareholders get some money from the bankers he says helped him perpetrate the fraud.

In another case, **Sanjay Kumar,** the 44-year-old former head of software maker Computer Associates International, pleaded guilty to charges of securities fraud and obstruction of justice in a $2.2 billion accounting scam. He expressed remorse. In November he was sentenced to 12 years in prison.

Ex-WorldCom chief **Bernard Ebbers,** 65, began serving his 25-year sentence in September at a federal prison in Louisiana. His chief financial officer, **Scott Sullivan,** cut a deal with prosecutors and is serving a five-year term.



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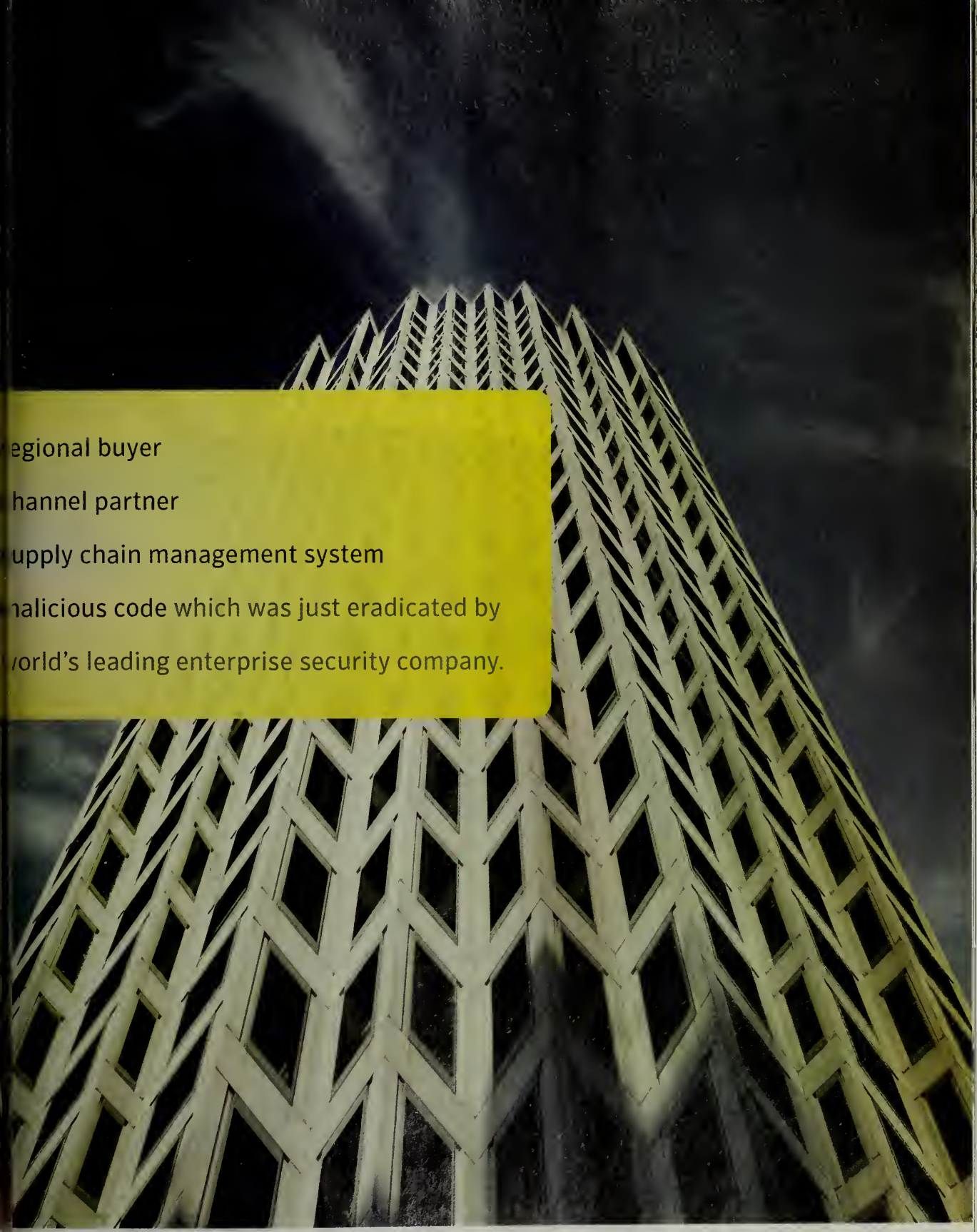

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EDITED BY BRIAN HINDO

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Now even the merely somewhat rich can travel like the very rich. The first "Very Light Jet" to win Federal Aviation Administration approval, the five-seater **500 Jet** made by **Eclipse Aviation** already has 2,500 orders. It weighs less than standard business jets, boasts a price tag about half as much as the next cheapest jet, and, the company says, costs much less to maintain. The planes could become staples of air taxi fleets. For those of us whose ambitions are more grounded, **Mazda's CX-7** crossover SUV is a hot seller thanks to its slick design, superior handling, and relatively low sticker price. At 18 to 24 mpg, it's a fine medium between huge gas-guzzlers and more pedestrian, more expensive hybrids. The most remarkable thing about the **Honda Gold Wing** isn't the built-in satellite navigation, the 80-watt-per-channel premium audio system, the antilock brakes, or the cold-weather comfort package (heated everything). It's the air bag—the first ever for a bike—which can protect against pitching into the handlebars and windshield during a head-on crash.

MAZDA CX
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BEST SALES PITCH

Before the **Philips Norelco Bodygroom** came along, bet you didn't even know you needed to shave, um, below the neck. Tons of guys have been persuaded to do just that, thanks to a viral marketing smash: a funny, not-safe-for-TV Web video describing all the places men can defuzz ($39.99, shaveeverywhere.com).

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BEST OF THE HOME LIFE

It wouldn't seem like a great idea to launch a new line of houses in the middle of a housing slump. But **KB Home** and **Martha Stewart** have sold some 300 models with "unique Martha touches" like wainscoting, and the rooms are painted in a trendy color palette. They're in planned neighborhoods in Georgia and North Carolina, with more to come in Texas and California. You can fill your Martha house with these well-designed products, all of which we're certain the domestic diva would deem "good things." A garbage can that you don't have to touch surely qualifies. The **Touchless trash can,** from **iTouchless,** uses infrared sensors to automatically lift and close the lid whenever your hand is near. It uses four D batteries and is sold online and at Target. Another tool to make cleaning less a chore: the **Dyson Root 6 hand vacuum.** It may look like a mashup of a Mr. Coffee and a 1930s-era comic book ray gun, but the pistol-like grip is a more natural way to hold and use a vacuum. And the 21.6-volt Dyson offers markedly better suction than conventional hand vacs. You may be able to cut down on the mess altogether—at least from your baby—with the Yves Béhar-designed **Calla Chair,** made for **Fleurville.** Named for the lily that is its inspiration, the high chair telescopes outward to bring your child closer as you spoon out the mashed carrots and peas. It's due in stores next May.

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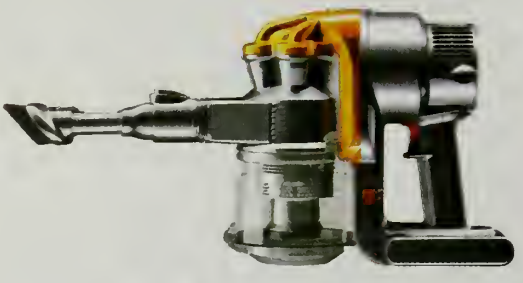

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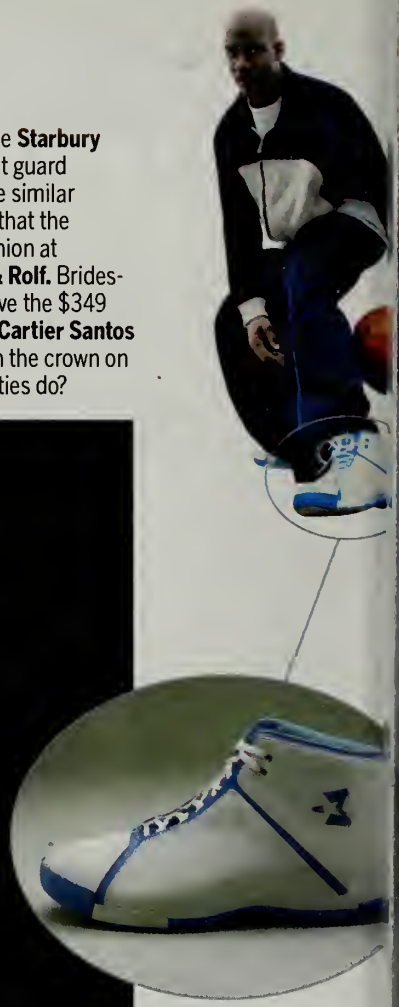
BEST FASHION STATEMENTS

Affordability never goes out of style. Consider the **Starbury One,** worn on the court by New York Knicks point guard Stephon Marbury and sold by retailer Steve & Barry's. The shoes are similar in style and quality to Nikes and Reeboks, but they offer something that the competition does not: a price of $14.98. H&M also delivers high fashion at accessible prices with its show-stopping **wedding dress by Viktor & Rolf.** Brides-to-be might disagree about the bow and the ruffles, but they'll all love the $349 price tag. Of course, if you just can't resist splurging, check out the **Cartier Santos 100,** one of the models now available in designs for southpaws, with the crown on the left side of the face. Shouldn't lefties have every luxury that righties do?

VIKTOR & ROLF WEDDING DRESS
$349, hm.com



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$449, mio-tech.com

BEST TECH GADGETS

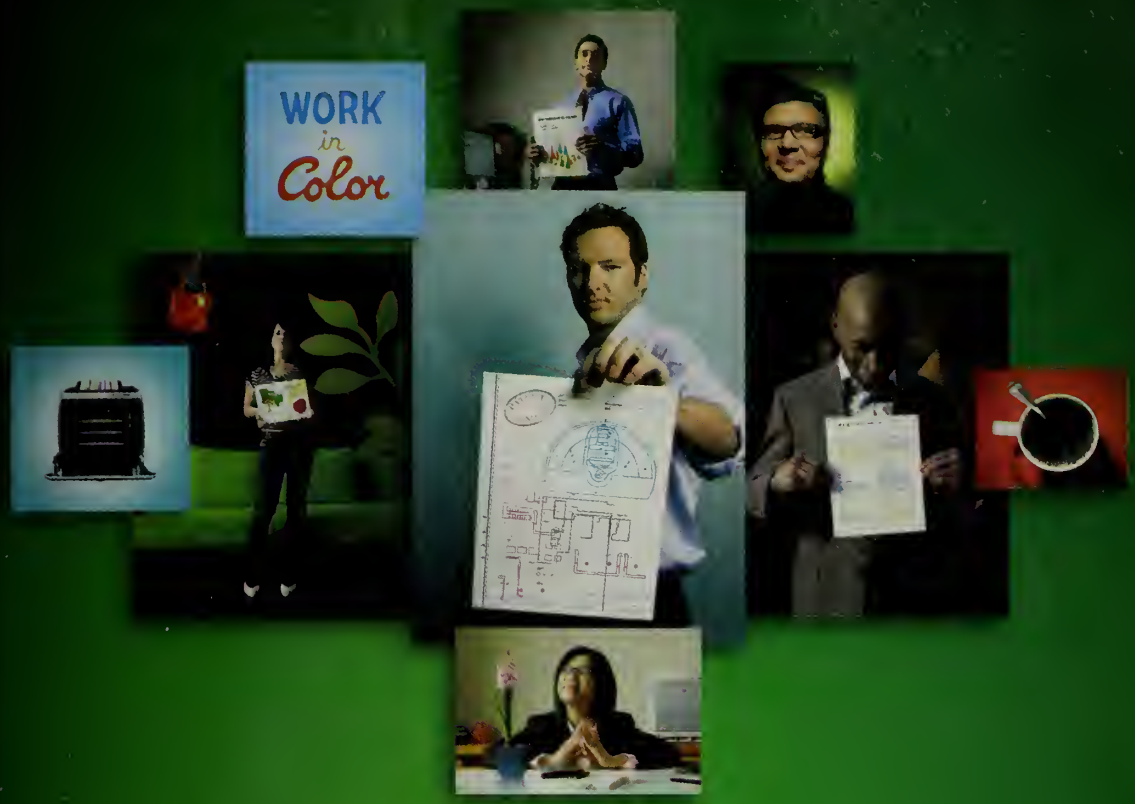
James Bond would admire a gadget as function-packed as the **Mio Digiwalker H610,** a palm-size GPS-MP3-video player. In the car, it lets you know when you pass places yo need—ATMs or emergency rooms, say—a it even tells you if you're speeding. The promi battery life is five hours, and it recharges through a USB connection. Perhaps even Bond would have a hard ti finding someone important enough to call on a $1,200 ce phone, but if he did, he would use the **Serene.** On the eleg and expensive joint effort from **Bang & Olufsen** and **Sams** the designers placed the display on the bottom clamshell avoid "greasy screen" phenomenon. You can flip it arounc to tap out text messages (as pictured, at left). The numbe arranged around an iPod-like click-wheel, recall the look c classic rotary phone. **Panasonic's Lumix DMC FZ50** is toc and bulky for spy work. But with its gigantic Leica 12x opt zoom lens (most point-and-shoots are 3x), it is the best o so-called ultrazoom digital cameras. Back at the office, **C Systems** hasn't invented a cure for meetings, but its lifelil life-size high-definition **TelePresence** meeting system ca at least make them more bearable. No more disembodie voices and fuzzy start-and-stop visuals. You'll think Miss Moneypenny is right in the room with you.

SERENE CELL PHONE
$1,200,
serenemobile.com

BEST LIFE SAVER

Merck has hit a home run with this first-ever vaccine, **Gardasil,** that protects against human papillomavirus. HPV is a sexually transmitted disease that causes cervical cancer and kills 233,000 women every year. It's a huge scientific breakthrough and figures to be a business success, too. Analysts think it could bring in $2 billion to $4 billion a year ($360, gardasil.com).

CISCO TELEPRESENCE MEETING SYSTEM
$299,000, plus maintenance, cisco.com



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Up to 8 pages a minute.
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$399.

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1-800-888-3119. Visit your reseller or retaile

Hewlett-Packard Development Campany, L.P. Estimated U.S. retail price. Actual prices may vary.

hp
invent

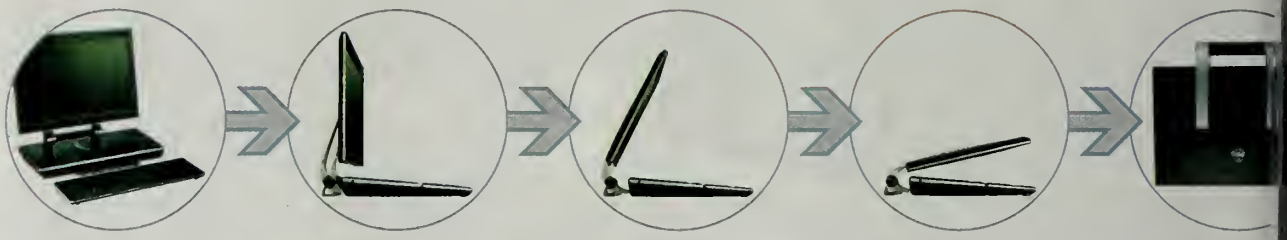
BEST DIGITAL FUN AND GAMES

These are not your father's Legos. The **Lego Mindstorms NXT** kit comes with rods and beams that work with light, touch, and sound sensors that allow you to build full-fledged programmable robots. Software allows you to write programs on a Mac or PC and connects with the bot via a USB cable (included). It's recommended for kids as young as 8, but older ones, not to mention gadget-minded adults, will likely be the most interested users. This isn't the **Nintendo** you remember, either. The **Wii,** at $250 the most affordable of the next-generation gaming machines, has a wand-shaped remote controller with motion and pointing sensors that allow it to be swung like a golf club or aimed like a gun. It's compact and an energy sipper, so it can be connected 24 hours a day to the Internet over Wi-Fi networks. Players can also create avatars, or digital look-alikes of real people, and give them cameo appearances in games. The **Dell XPS-M2010** laptop comes with a remote control, too, so you can watch TV or movies on its 20.1-inch, wide-screen display from the couch. The powerful system packs a multimedia punch, with a detachable wireless keyboard and fully loaded video and audio components. It also folds into a handy briefcase. In an otherwise forgettable year for Dell (p. 76), this is a design triumph.

NINTENDO WII
$250,
wii.nintendo.com

LEGO MINDSTORMS NXT
$250,
mindstorms.le

DELL XP M2010
$2,999
dell.com



The Jury Is Still Out

Microsoft Zune

The reviews are in, and decidedly mixed, on Microsoft's challenge to the iPod. The Zune is cool looking, with a big display and 30 gigs of space for music, pics, and movies. But will anyone really care about its most unique feature: the ability to share songs with other Zune users within a 30-foot radius? Some analysts have predicted sales of up to 3 million units in the first year of the Zune's release, but for Microsoft even to move 2 million would be a huge feat—and that number still would be just a fraction of iPod sales. ($249.99, zune.net)

Last.FM

This free, music-centered social networking site tracks wha its users are listening to on their computers or iPods and then automatically clues them in to what similarly minded people like. The four-year-old London fledgling rolled out a host of features this year, such as a service that points out concerts in your area and a customized rad stream. Last.FM has lured venture money and 15 million users already, but will it be able to entice the masses—and will it snatched up by a bigger Web 2.0 fish? ($0, last.fm)

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The Worst Products

Sony Lithium-Ion Batteries

Sony's lithium-ion laptop batteries malfunctioned in the worst possible way: publicly and destructively. The bad ones didn't just conk out, they overheated to the point where they actually set laptops ablaze (right). Even worse for Sony, a few of the flame-ups were caught on tape, including one at a conference in Japan, and quickly made the Internet rounds. The result was a massive recall, which will end up costing the company about $430 million, possibly more if some Japanese PC makers follow through on threats to sue. But the hit to struggling Sony's reputation as a technology leader is what really stings.

American Girl Jewelry

Dollmaker **American Girl,** a division of Mattel, voluntarily recalled some 180,000 pieces of its **jewelry** for real little girls, sold in New York, Chicago, and Oshkosh (Wis.) stores, after an internal audit found unacceptably high levels of lead in the baubles.

ESPN Mobile

In a rare stumble, the self-proclaimed "worldwide leader in sports," **ESPN,** failed in its ambitious bid to become a mobile operator. Customers balked at the hefty $199 price tag for the **phone,** plus the monthly charges for service (up to $225), and the hassle of switching phone plans. Ultimately, the service didn't deliver much unique content. The product, a raspberry for the otherwise high-flying Disney unit, was unceremoniously dumped.

Vonage IPO

Shares of this profitless broadband phone company are off 60% since they made their initial public offering in May. Disappointing investors is one thing, but when many are also your customers it's a full-blown nightmare. **Vonage** persuaded many of its users to reserve shares in the IPO—one of the more predictable stinkers of the year—and then had to chase them down for the cash after the IPO tanked.

Spalding NBA Basketball

The **NBA's new ball,** made from a microfiber composite, is meant to offer a more consistent bounce than the old leather models. Instead, it has sparked incessant complaints from players, who say that it slips when their hands get sweaty and even causes skin abrasions. The players' union has filed a formal grievance.

Some think
privileged.

**We think
customized
solution.**

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IDEA

(LEFT TO RIGHT) DAN PAGE; KULKA/

REE LABOR

YEAR 2006 may be remembered as *nnus mirabilis* of work. Whether it es from open-source lopers, obsessive angry customers, or ly Web addicts look- o burnish their egos a little attention e, businesses have ed how to leverage ratis workforce as r before. So much so futurists Alvin and i Toffler argue that suming," or creat- hat we consume, structuring the omy by funneling money from the en economy back he mainstream one economists track. any people, this nts to an extra non- g job—one that's on behalf of some e biggest corpora- in the world. This, offlers say, will ally rework the way ake, measure, and pulate wealth. The ment encompasses everything from the creation of software such as the Mozilla Firefox browser, to user-generated advertising for a Doritos spot for the 2007 Super Bowl, to online news sites such as Digg.com.

Letting users participate in the creative process not only brings in new ideas, it provides a natural incentive for them to spread the word and generate PR juice. For marketers, user-generated content is becoming a valuable trend-mining tool. For Web developers, releasing source code for outsiders to build on has become integral to maintaining a competitive edge. Already, though, rumors abound that companies are paying people on the sly to act as consumer ambassadors, eroding confidence in the new model. How long before the unpaids start stomping for their cut? Catch them while you can.

TRADE'S THE THING

THE POWER OF investment banking is giving way to trading on Wall Street. Investment banks are figuring out how to make stacks of money by trading almost anything, ranging from derivatives on people's mortgages to carbon emissions. There once was a time when investment banks were defined by the quality of advice they gave to CEOs struggling with big decisions. But it turns out that banks can make just as much money, if not more, by assisting companies with trades on their own books. Trading has soared to become 33% of the revenues of major banks and brokerages, up from 26% in 2003, estimates Prudential Financial Inc. Mastering new trading methods and their potential dangers has become key to banks' success. So the stock of Goldman Sachs, the leader of the trading pack, has been on a tear, soaring 57%, to 200, in one year. Superstar traders are getting bonuses of as much as $40 million. Not bad, eh?

The concepts that are reshaping the business world–and all of our lives

EDITED BY MICHELLE CONLIN

TREND MINING

SOCIAL NETWORKS, blogs, vlogs, YouTube—they're all leaving a digital trail about you and your brand. No surprise, then, that a host of new trend miners are working to help you make sense of all this noisy clatter. Nielsen BuzzMetrics' BlogPulse creates customized graphs of blog conversations, measuring the influence of individual blogs and fingering what people are typing about, from Hollywood (buzz is boundless on Angelina Jolie, but flagging on Paris Hilton) to politics (chatter is up on the Supreme Court and down on the federal budget deficit). Digitas ad guy David Armano's Logic+Emotion blog provides visualizations of the blogosphere's spheres of influence and plays host to rich trend conversations by advertising thinkers. Google Trends uses graphs and charts to present data on the public's Googling habits. Some might pioneer fee-for-service or ad-based models as traffic and interest grow. But for now most of these services are blissfully free. There is even a Web analytics site called HitTail.com that analyzes blog traffic and search patterns to spit out future post suggestions for bloggers eager to stay ahead of emerging trends and spike their rankings. A few simple algorithms can discern not only what people are talking about now but what they will be talking about in the future. Who needs a gut anymore?

GET A SECOND LIF

IN 2006 THE fast-rising virtual world, Second Life, became the hottest commercial (un)real estate online. It resembles a video game, but here people create avatars, or graphic representations of themselves, and proceed to build everything inside the world, from buildings to businesses. Thousands of people make at least $20,000 a year from selling virtual clothing, houses, shopping malls, games, and more. And now there's a virtual land rush by established businesses, all hoping to crank up their hipness quotient by creating a presence in Second Life. Starw Hotels & Resorts has a hotel inside Second to promote its prope ties in the real world. Reuters has assigned a reporter to chronic events inside. Even If CEO Sam Palmisano recently appeared as part of the computer company's push to p 3-D worlds. The busi nesses hope not only to reach new audien but also to engage th more fully in their br than they can in the world, where traditic advertising seems to have diminishing ret Virtual worlds could to the future of the W

TINY CHIC

YOU KNOW something's in the air when truck-lovin' Texans are swapping Expeditions and Tahoes for smaller Korean cars and SUVs. Jim Hardick, who runs Chevrolet, Chrysler/Jeep, and Kia Motors dealerships in Fort Worth, says that in months when gas hit $3 a gallon, his Kia stores saw buyers swapping SUVs for Korean compacts. Says Hardick: "I've never seen anyt like it." Get used to it The year 2006 mark return of the small c As SUV sales and pr tank, tiny vehicles ha made a comeback. S of subcompacts like Toyota Yaris (above) Honda Fit are up 42 year. Both sell for ar $15,000, nicely equi More proof that sma hot? New models fro BMW and Audi.

he bad news:
ki Patrol just closed the mountain.

The good news:
Ski Patrol just closed the mountain.

Don't let erectile dysfunction (ED) hold you back from a fulfilling sexual experience.

- Viagra is prescribed for all degrees of ED, even if it only happens once in a while.
- Maintaining an erection is important. It's just as important as getting a firm erection. Viagra can help with both.
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VIAGRA®
(sildenafil citrate) tablets

What are you waiting for?

our doctor if Viagra is right for you. And enjoy what it can do to help you improve your sex life.

RA is prescribed to treat erectile dysfunction. We know that no medicine is for everyone. If you use nitrate drugs, often used for chest known as angina), don't take VIAGRA. Taking these drugs together could cause your blood pressure to drop to an unsafe level.

vith your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, nedical help right away.

igh erections lasting for more than four hours may occur rarely with all ED treatments in this drug class, to avoid long-term injuries, it ortant to seek immediate medical help.

instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of It is not possible to determine whether these events are related directly to these medicines or to other factors. If you experience sudden se or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

ost common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being ve to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

RA is covered on the majority of National Health Plans.[1*] VIAGRA is one of several ED treatments that you and your doctor can consider.

and PPOs; Some plans may require a prior authorization.

Media Information Technologies, Formulary Compass™ August 2006

To learn more, visit viagra.com or call 1-888-4VIAGRA (1-888-484-2472)

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PATIENT SUMMARY OF INFORMATION ABOUT VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- Nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- Isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV—the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- Have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- Have ever had a stroke
- Have low or high blood pressure
- Have ever had severe vision loss
- Have a rare inherited eye disease called retinitis pigmentosa
- Have ever had any kidney problems
- Have ever had any liver problems
- Have ever had any blood problems, including sickle cell anemia or leukemia
- Are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- Have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- Have stomach ulcers or any types of bleeding problems
- Are taking any other medicines

• VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking medicines called alpha-blockers for the treatment of high blood pressure or prostate problems, your blood pressure could suddenly drop. You could get dizzy or faint.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

Your doctor may prescribe a lower dose of VIAGRA in certain circumstances. For example:

- If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA.
- If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period.
- If you have prostate problems or high blood pressure for which you take medicines called alpha-blockers, your doctor may start you on a lower dose of VIAGRA.

• How To Take VIAGRA

Take VIAGRA about 1 hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose

In case of accidental overdose, call your doctor right away.

• Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

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Pfizer Labs

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LAB-0220-5.0
June 2006

VEB 2.0 GOES CORPORATE

BE IT WAS seeing easily their kids ssed hundreds of nds" on MySpace. atching the blogs ll viral on bad news ut their companies. tever the reason, agers discovered al-networking tools nasse this year. They e from MySpace-like essional networks nding jobs or sales s to network-mapping vare that helps managers visualize who turns to whom for expertise.

The range of applications is endless. Goldman Sachs uses a social-networking program called SelectMinds to track its alumni. Raytheon creates maps showing employees' relationships to find its most connected people. And IBM has an internal network, called Dogear, of company Web pages or documents that other employees have bookmarked as beneficial. With growing interest in corporate social networking comes a horde of new products and services. Microsoft will be adding its own social network tool by next year, a feature called Knowledge Network that is part of its 2007 Office suite. Knowledge Network will collect data from e-mails and other Office documents to create a profile of a user's expertise.

EMBRACING AFRICA

WHETHER IT WAS BONO and Bobby Shriver using stars like Chris Rock (below) to launch Product (RED) and raise funds to fight AIDS or Brangelina heading to Namibia to give birth, this was the year that Africa became trendy (again). The continent's status surged as everyone from celebrities to corporate icons flocked to its doorsteps. Many were motivated by a desire to alleviate the misery caused by disease, poverty, and devastating civil strife in areas like Darfur. Some simply wanted to jump on the bandwagon and be seen as helping the cause. Madonna, meanwhile, managed to generate her own controversy by appearing to sidestep proper procedures in adopting a boy from Malawi.

But Africa isn't simply the object of charitable efforts these days. With its rich resources and underserved populations, Africa is also a business opportunity. Billionaire Sir Richard Branson has already tapped into that with such ventures as Virgin Nigeria Airways and South Africa's Ulusaba private game reserve. Even the threat of rebel attacks or unrest has failed to dampen interest in energy-rich countries like Nigeria, which got a $2.7 billion investment earlier this year from energy giant China National Offshore Oil Corp. The Chinese government also hosted a summit of African leaders in Beijing in October, signaling the region's growing importance and the likelihood of future friction over critical alliances on the continent.

The most immediate focus, though, has to be on Africa's humanitarian crisis. About 14% of the adult population is estimated to be infected with HIV, and millions have been killed or displaced by war or famine. Malaria alone causes at least a million deaths each year and cuts up to 1.3% off the growth rate of some countries, according to the World Health Organization. Corrupt regimes and civil war also make it hard to close the mammoth income gap or administer aid. Societies of orphaned children and elderly residents who dodged the AIDS bullet can't be as productive as ones that burst with young, healthy adults. Increasingly, the world has realized that a thriving Africa can contribute much to the global economy. But the continent needs help to beat back the ills that, for too long, its people have suffered largely in silence.

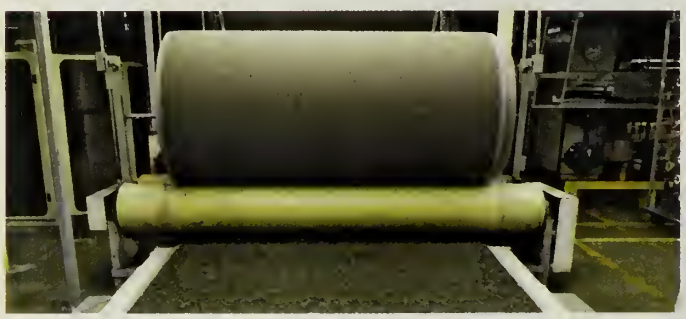
(TOP) DAN PAGE

MICROLOANS

TEACH A MAN to fish, and he'll eat for a lifetime. But only if he can afford a fishing rod. More than 30 years ago in Bangladesh, economics professor Muhammad Yunus (right) recognized that millions of his countrymen were trapped in poverty because they were unable to scrape together the tiny sums they needed to buy productive essentials such as a loom, a plow, an ox, or a rod. So he gave small loans to his poor neighbors, secured by nothing more than their promise to repay.

Microcredit, as it's now known, became a macro success in 2006, reaching two huge milestones. The number of the world's poorest people with outstanding microloans was projected to reach 100 million. And Yunus, 66, shared the Nobel Peace Prize with the Grameen Bank he founded. The Nobel committee honored his grassroots strategy as "development from below."

You know an idea's time has come when people start yanking it in directions its originator never imagined. Some, like Citigroup, are making for-profit loans, contrary to Yunus' break-even vision. Others, like Bangladesh's BRAC, are nonprofit but have a more holistic vision than Grameen, offering health care and social services in addition to loans.



SUPER RECYCLING

MANUFACTURERS have long wrung efficiencies out of people. Why not try it on raw materials? Dubbed remanufacturing, the idea is simple: Take back used goods, build them back up to "like new" condition, and resell them. Carpet maker Interface Inc. uses reclaimed materials in its carpet tiles' vinyl backing. The concept has been around forever, but in 2006, persistently high material and energy costs allowed companies such as Caterpillar and Xerox to save a bundle. Cat's diesel engine remanufacturing operation, one of the Peoria company's fastest-growing units, nearly doubled its size in June with the $1 billion acquisition of train-car remanufacturer Progress Rail. And in red-hot sectors like oil-field services, the only way a company like Hanover Compressor, whose products help squeeze natural gas out of deposits, could quickly meet surging demand was to remanufacture its fleet of skids. Building new ones from scratch would have taken too long. Another timely by-product: Super recycling is super-friendly to the environment.

GLOBAL WARMINC

THIS WAS THE year global warming went from controversial to conventional for much of the corporate world. From AIG to DuPont to Duke Energy, a growing list of blue chips are formally including climate change in their long-range plans. For some, like Wal-Mart, that means a new zealousness to build low-energy stores. For others, such as GE, it me customizing products to deliver ultra-high efficiencies.

Why the shift? Mar chief executives spea of a personal awaken to the threat of clima change. But even for those who remain sk cal, pressure is sudd coming from every di tion. Big institutional investors are pushing companies to accour their carbon dioxide put, given that it's lik hit the balance sheet liability sooner than expected. Insurers ar shaping policy terms bumping up rates in sponse to bigger stor worse fires, and long droughts. Climate ca are multiplying in the courts too. And desp resistance from the House, with congres nal and local politics getting greener, carb limits look more like matter of if—not whe

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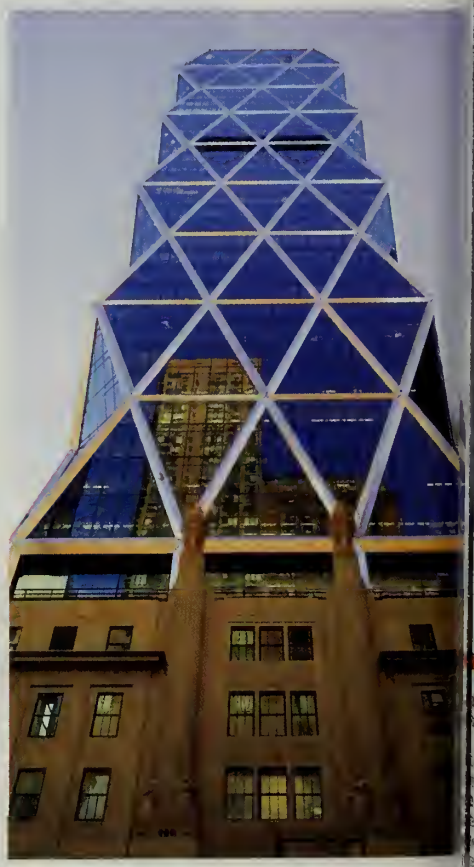
MATH HAS YOUR

MORE AND MORE of the economy is falling into the world of numbers. As we live greater parts of our lives online—working, playing, socializing, and shopping—we're becoming one giant archive. We feed networks slews of digital data that once would have languished on paper or disappeared into the ether. All these bits of information sit in databases, many of them in the public domain. From a business point of view, all that information is just begging to be sliced and diced and turned into new businesses, industries, and marketing opportunities. It's not just Wall Street and Silicon Valley where math rules anymore. These days industries from food and beverages to advertising to intelligence agencies are leaning more and more heavily on mathematicians. California consultant Enologix is using algorithms to mimic the chemistry of wines ranked highly by critic Robert Parker (page 144). Online advertisers are using math to optimize the efficiency of campaigns. And the National Security Agency uses quantitative means to find patterns in phone and Net traffic to identify potential terrorist threats. The math geeks aren't holed up in the back office, anymore. They're playing increasingly important roles in corporations—and being highly rewarded.

GREEN IS GOOD

SET FOOT INSIDE
Hearst's new headquarters just south of Central Park, and you actually might have fantasies of moving in. The ambience is so un-New York: fresh and cool, even on a global-warmed afternoon. A three-story-tall sloping wall of water, fed by stored rainfall, keeps the glass-roofed atrium moist year-round, cooling it during warm months. Thanks to the building's floor-to-ceiling windows and open-plan construction, natural light washes deep into every floor. And when daylight is abundant, sensors automatically dim the overheads. That has helped slash the power bill by 25%.

The Hearst Building (below) has lots of c pany in this year's g all-star category, in ing Adobe's new Sili Valley headquarters Google's installatio solar panels at its Mountain View (Cal headquarters, and t new Bank of Americ tower in New York. I glassy wonder, now emerging over Brya Park, is expected to become the greene office tower in the U complete with a livi green roof and sens that know when to fresh air into stuffy meeting rooms. Healthier workers. Fantasy digs. A sma contribution to glob warming. Green is



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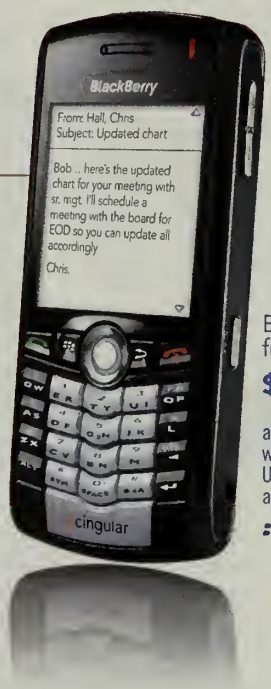

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ETFs: HEDGE FUNDS FOR THE PEOPLE?

FOR THE PAST decade, exchange-traded funds have been little more than repackaged stock-index mutual funds. But 2006 will go down as the year that ETF innovation exploded, finally giving everyday investors access to something useful and new in an uncomplicated, low-cost package.

As in previous years, the overall size of the ETF market jumped. With assets of $383 billion at the end of October, ETFs gained 45% from 12 months earlier. The news this year was that with all the basic indexes covered, fund managers had to look for new niches. This year's offerings included funds tracking silver, oil, and other commodities, along with funds investing in overlooked industries such as clean energy technology and regional banking. Firms like WisdomTree Investments and Rydex Investments even turned to academicians to create ETFs that try to improve the performance of plain-vanilla index funds. Rydex's "equal weight" sector funds divvy up S&P 500 stocks into nine broad industry groupings without letting the performance of market titans such as Exxon Mobil dominate their group the way they do ordinary stock indexes. Ever since the Internet bubble burst, investors have been searching for the holy grail of diversification. Adding international stocks helped, but overseas markets are tracking the U.S. more closely. So there was a huge untapped market for new ETFs. Next year will see more niches opening to the masses, such as ETFs for non-U.S. real estate and infrastructure construction.

The Jury is Out

Private Equity

Feel the tremors? Private equity giants like Kohlberg Kravis Roberts, Blackstone Group, Carlyle Group, and Texas Pacific Group are seismically changing the landscape of industries from semiconductor producers to hospital operators. And they're just getting started. In 2006, private equity firms bought $628 billion worth of companies around the globe. Bankers estimate they have amassed $2 trillion more buying power. Is this a good thing? To the firms' investors, many of which are pension funds and endowments, the returns that private equity firms produce—in excess of 20%—are manna. Buyout shops are achieving stellar yields by making more operational improvements than ever before to the companies they own. Still, some companies owned by private equity firms are ending up worse off. About 64% of buyout firms' returns still come from what Wall Street likes to call the "financial engineering" of companies. Now the burden is on the private equity players not to get carried away with their zeal for big bucks.

SarbOx

The intentions were good. But in the two years since its passing, the Sarbanes-Oxley Act has collapsed into a glob of regulatory confusion costing U.S. businesses billions of dollars a year in compliance costs. Now comes the mad dash to fix the statute, which is being blamed for chilling markets, triggering a drain of capital, and chasing investors and investments offshore. On Nov. 30 a long-awaited report from committee of Wall Street VIPs gave its best idea: Let's tinker. Rather than repealing SarbOx, the committee recommended minor changes to the law, such as relief for small companies and better guidance from regulators on how to apply the rule. The act never got the vetting it deserved because of the race to approve it after the Enron and WorldCom meltdowns, but the SEC, under Chairman Christopher Cox (above), is hoping to make improvements by spring. Because of SarbOx, last year a record number of U.S.-listed companies restated their earnings—close to 1,300, or over 8% of the total.

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OPTIONS BACKDATING

It has prompted the biggest corporate probe since the mid-1970s. By yearend, more than 200 companies faced questions about options grants, including Cablevision, Barnes & Noble, and Broadcom. Over 75 of them plan to restate earnings to account for charges totaling more than $5 billion. Some 66 execs have lost their jobs, and a handful have been indicted. In July, not long before he and two others from Comverse Technology were to be charged with fraud linked to backdating, former CEO Jacob "Kobi" Alexander (left) disappeared. A manhunt tracked him down in Namibia. He is fighting extradition to the U.S., where he faces up to 25 years in prison.

PUTTING IT IN E-MAIL

When will we ever learn? RadioShack fired employees via e-mail and suffered a rash of horrible publicity. Mark Foley ruined his political career by corresponding online and ended up in rehab. Then there's Kevin Hunsaker, Hewlett-Packard's former chief ethics officer. After being told the tactics the company used to obtain phone records were "on the edge, but aboveboard," he replied: "I shouldn't have asked." Actually, he should have.

IF I DID IT

He should have never done it. O.J. Simpson's book, detailing how he would have committed the 1994 murder of his ex-wife, Nicole Brown Simpson, and her friend Ron Goldman, was characterized by his publisher, Judith Regan, as his "confession." It earned the world's opprobrium as an "evil sweeps stunt" that will be remembered as a low point in American culture. Regan's boss, News Corp. Chairman Rupert Murdoch, finally caught on, canning the book and TV special. But not before pre-orders for *If I Did It* cracked the Top 20 on Amazon.com.

PRETEXTING

What to do about the problem of board members blabbing to reporters? No doubt, leaks can be about anything from a petty annoyance to a serious issue to a means for dissident directors to funnel key information to investors. Whatever the case, it's now clear Hewlett-Packard should have resisted the temptation to act like a Hollywood P.I. After what seemed to be recurring high-level leaks, Chairwoman Patricia C. Dunn launched a probe in which hired investigators used aggressive tactics—most famously, "pretexting," or lying—to get home phone records. It was an astonishing reversal for a company with a spotless reputation for corporate morality. And an object lesson in the hazards of shoddy ethics—or lousy oversight of ethically shoddy behavior.

WAL-MART TRIES HIP

Attempts by the brass in Bentonville, Ar take the discounter upscale à la Target floundering. Wal-Mart Stores even put a in *Vogue*, though the clothes (above) we anything but vogueish. Attempts to be on the digital front were a much lampo failure. The company's social networkir site, The Hub, was a MySpace wannabe censored content. A blog started by an traveling couple turned out to be funde the company, a major PR faux pas.

'AFFORDABLE MORTGAGES'

With the real estate market's vertiginous climb, many Americans were priced out of home ownership. The lending industry came up with a perfect solution: exotic mortgages. The payment-option ARM loans were a way allow the working class to pay the sma est amount possible toward their mon mortgages. But with payments less tha interest owed, borrowers actually incre the total balance, a situation called ne amortization. Once a balance grows to certain amount, the loan resets at a hi payment. This year, borrowers saw opt ARMs' other side: debt bombs in disgu

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SpecialReport Investigations

Bitter Pills

More and more people are buying prescription drugs from shady online marketers. That could be hazardous to their health.

By Brian Grow, Ben Elgin, and Arlene Weintraub

FROM THE OUTSIDE, IT LOOKED LIKE any other white-walled, terra cotta-roofed bungalow in sun-bleached Belize, perhaps someone's quaint tropical hideaway. Inside, however, the house's peripatetic occupants didn't act like they were on vacation. Workers in sneakers, shorts, and rubber gloves produced mountains of allegedly counterfeit prescription pills. Hundreds of pounds of raw ingredients came from China via a broker in New Jersey. The drugmakers whipped up their products in a dented mixing machine and blender. Finished tablets—imitations of Viagra, the cholesterol medication Lipitor, and Ambien, a sleep aid—were stored in gray garbage bins before being shipped out in plastic sandwich bags. The pills allegedly were hawked via spam e-mail and sold, without prescriptions, from such Web sites as www.planetpharmacy.bz.

According to the U.S. government, the brains behind the Belize operation belonged to Jared R. Wheat, a 34-year-old Atlanta-area businessman with a colorful history of marketing drugs and dietary supplements. This alleged enterprise typifies a burgeoning online black market in phony prescription drugs. One way in which the organization isn't typical, though, is that the government took action against Wheat. In September federal agents arrested him in Atlanta on charges including importation of controlled substances, disseminating adulterated drugs, and running a "continuing criminal enterprise." He has pleaded not guilty to all 45 counts against him and is jailed in Atlanta, awaiting trial next year.

His lawyers say he has been wrongly associated with the prolific little house in Belize and the dubious Web sites that marketed its output. In a written statement, the lawyers add that their client "has substantial defenses in this case, however, rather than airing them in your publication and therefore giving the government the benefit of that information, we intend to produce that information to a jury at trial and to the court in the form of legal challenges."

The pharmaceutical industry and U.S. law enforcers say they are increasingly worried about online pill pirates, but

Workers made bins of counterfeit pills in prim unsanitary conditions in a Belize bungalow ar them online, U.S. prosecutors allege

they are rarely successful in shutting them down. Recently security officials at AstraZeneca put fake and genuine versions of its $4.6 billion-a-year heartburn medicine Nexium on the desk of CEO David Brennan. They looked exactly the same, he says. "This is a very serious problem that is accelerating," Brennan adds. "It's hugely profitable for the people who do it." Jon L. Praed, an attorney at Internet Law Group in Arlington, Va., which tracks illegal pharmacy sites for drug companies, estimates that Internet counterfeits generate billions of dollars in revenue a year, a figure consistent with those offered by other experts.

Several factors drive demand for cheap drugs on the Internet: Drug prices in the U.S. exceed those in other developed countries by 18% to 67%, and more than 46 million Americans lack health insurance. A growing number of employers are pushing employees to order lower-cost generic drugs from pharmacy Web sites. This has spawned legitimate online sellers, such as Walgreens.com, CVS.com, and medco.com. But shady operators are far more pervasive—and more convenient for people who want to avoid the hassle or embarrassment of obtaining a doctor's prescription. Based on a study of 185 sites, Columbia University's National Center on Addiction & Substance Abuse reports that only 11% o net pharmacies require customers to provide a presci All the rest, an astounding 89%, appear to operate il Conservative estimates of the number of dubious site into the tens of thousands, according to Internet Group Inc., a corporate consulting firm.

Rogue drug distributors find customers mainly via Internet security experts concur that nearly 25% of all or some 15 billion messages a day, is spam advertising mostly counterfeits. Even if recipients click on only fraction of these offers and buy something after a mi percentage of their clicks, that would still translate in of thousands of online drug purchases a day. James Ch who heads global security for Novartis, estimates the r of Americans buying drugs online is "in the millions."

The Online Drug Trail

Millions of unsolicited e-mails hawking phony pharmaceuticals reflect a sophisticated global industry. Here's how it typically works:

SOME ONLINE PHARMACY operators use stolen identities and front companies to register numerous Web sites, which trace back to a central business

THE INTERNET DRUG SELLERS hire professional spammers to bombard consumers with e-mail offering prescription drugs, often falsely marketed as cheap, safe Canadian imports

SPAMMERS AND PHARMACIES use such gibberish names as www.defunkderiosa.com and other deceptive methods to bypass e-mail filters and hide from investigators

WHEN ORDERS COME IN, they are filled and shipped by knock-off drug suppliers in China or India, which have contracted with the online pharmacies

CONSUMERS' CREDIT CARDS are usually charged by merchants with generic-sounding names; pills—some effective, some completely fake—arrive via FedEx or DHL

NO ACTIVE INGREDIENTS

THE PROFUSION OF FAKES puts consumers at risk. So line drug shipments seized by U.S. authorities have tur to be near-replicas of brand-name products. But othe enough active ingredients to do any good, or are too Either way, they endanger users.

Foreign substances sometimes end up in the pills. Viagra made in Thailand has contained vodka; bogus recovered in San Francisco was manufactured with Vit and lactose. Online purchases *BusinessWeek* made in con with this article yielded imitations of Lipitor and the an ety medication Xanax that laboratory tests showed had n ingredients whatsoever (table, page 114).

Craig Schmidt fell victim to questionable Internet cine in April, 2004. The Chicago plastics salesman, tl was feeling the stress and back pain of long workweek spent on the road. Checking his e-mail one day, he r ads for Xanax and the painkiller Ultram. He placed in orders without ever speaking to a doctor. When tl arrived, he took one tablet of each drug and headed fo rand at the hardware store. The next thing he remem waking up three weeks later in the hospital. It turned c each Xanax tablet contained 2 mg of the drug, or qua the usual starting dosage. The combination app caused him to black out and wreck his car. He had attack, fell into a coma, and suffered brain damage. A extraordinary recovery, he still takes medication to p severe leg spasms. "Don't do what I did," he says. "I playing Russian roulette."

Fearful that too many cases like Schmidt's could le

keys to a successful IP transformation.

by verizonbusiness

UPGRADE?

Frame Relay or ATM systems are and the cost of maintaining your t network equipment is growing, be time to upgrade to IP. Not just advanced capabilities IP provides the efficiencies gained from a treamlined network. You could those efficiencies more quickly ou think, so if you're ready for IP, n't pay to wait.

ONE IP AT A TIME.

ompanies begin with one enterprise cation, such as an automated r expense system, customized unique needs. Then they advance like VoIP that can quickly interoffice and customer relations ties. The provider you choose offer a wide range of IP applications, pility to customize them to your s needs, and the expertise to them all at any scale.

SIMPLIFY WITH MPLS.

MPLS-based Private IP offers two key advantages: It simplifies your network topology by providing any-to-any connectivity, and it delivers multiple classes of service, so you can prioritize voice, video and data traffic over a single network.

THINK GLOBAL.

Make sure your provider's capabilities extend as far as your business goals: Is their IP technology deployed globally? Are their IP solutions scalable? Do they have wholly owned points of presence in every country where you have an office or mobile employee? And are you satisfied with their record of security, availability and reliability?

PLAN, ORCHESTRATE, MANAGE.

Your transition to IP is an ongoing process, not a project with an end date. So the experts you choose to facilitate it should be with you from the beginning and stay with you as your needs evolve. Look for a complete partner, one that will commit to strategizing, designing, implementing, managing and optimizing your IP technology. In other words, work with a company that backs up its capabilities with accountability.

TALK TO AN IP LEADER.

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Only 11% of WEB PHARMACIES require a prescription. An astounding 89% appear to operate illegally. Some 15 billion e-mail messages a day are SPAM FOR DRUGS, yielding tens of thousands of purchases a day

public-relations disaster, legitimate manufacturers are struggling to stop suspect Internet pharmacies. Last year, Pfizer filed suit in federal court in New York alleging that two online pharmacies were selling knockoffs of its products, including Viagra. One case fizzled when Pfizer couldn't figure out who ran the site. In the other, company investigators obtained dozens of e-mails sent by Ashok Agarwal of Mumbai, who allegedly sold counterfeit drugs on the Internet. In one message, Agarwal warned shippers in the U.S. to exercise caution, saying: "Our products are not U.S. FDA approved and will not carry any doctor's prescription." Served with legal papers in India, Agarwal has refused to appear in an American court. In March, 2006, Pfizer won a default judgment ordering him not to market anything that resembles Viagra or claim that his products are linked to Pfizer. But there is little the company can do to enforce the judgment. Agarwal, says Pfizer's vice-president for global security, John Theriault, "is beyond the reach of U.S. law. He's home free." Efforts to reach Agarwal for comment were unsuccessful.

The operation in Belize got Pfizer's attention in 2002, when the company filed a complaint with the U.S. International Trade Commission seeking to block Web sites selling knockoff Viagra. Among the sites were at least two that prosecutors say are affiliated with Wheat, but at the time no one connected them to the Atlanta pill entrepreneur. Wheat and his group, meanwhile, were building a lucrative drug empire online and off. According to a Sept. 14, 2006, Drug Enforcement Administration affidavit, from 2000 through this year more than $100 million was deposited in four bank accounts for companies controlled by Wheat. His attorneys have offered records in court showing that in 2005 he personally raked in $3.9 million—all honest money, the lawyers say, though the government begs to differ.

Jailed on drug charges in the 1990s, Wheat is now accused of illegally importing prescription pills

JAIL TIME

SMART AND GREGARIOUS, Wheat grew up in comfort in Birmingham, Ala. His father, Robert, was a bank executive; his mother, Carol, worked as a teacher and librarian. In letters filed in federal court in Atlanta, relatives describe a close-knit family in which young Jared thrived. He was an A student and a member of the National Honor Society and Math Honor Society. His mother notes that he still calls his sisters by their childhood nicknames, "Ginge" and "Shrimpy."

By age 18, however, Wheat had taken a wrong turn. He pleaded guilty in 1991 to selling MDMA, or ecstasy, an illegal euphoria-inducing drug popular at clubs and raves. That put him behind bars for two years. Wheat's supervised release revoked, and he returned to prison in Alabama for two years in 1995 after being arrested with 30 pounds of marij and $17,000 in cash. Interspersed with his criminal pur and periods of incarceration were two years of business cl at the University of Alabama at Birmingham.

Wheat incorporated a company in 1998 called Hi-Pharmaceuticals Inc. It was based in a two-story strip north of Atlanta on Jimmy Carter Boulevard, just of terstate 85. During this period, according to the DE began working with David A. Brady, now 40, from who appears to have learned new mark techniques.

Brady, according to a 1998 Fe Trade Commission filing, marketed tile-dysfunction products with flyer included endorsements from fict physicians, such as a Dr. Alan Brad of a fabricated Carnegie Research tute. Brady also set up front comp with names like the Institute of S Research and plagiarized a research from *The New England Journal of Me* to give his products a patina of sci legitimacy, the FTC said. The agen tained a permanent injunction in barring Brady from falsely marketin potence products. Brady, who didn' cede liability in the FTC matter, ha charged with 41 criminal counts Atlanta case. He has pleaded not his attorney declined to comment.

The FTC has separately claime Wheat incorporated his own netw dubious scientific entities, includi National Urological Group Inc., to market herbal weig and impotence pills. The network used a licensed doctor dorse misleading claims associated with the products, s enabling users to lose 30 pounds in just 60 days, the FTC November, 2004, the agency sued Wheat and Hi-Tech in court in Atlanta over these practices. Wheat has denied doing and alleged procedural violations by the FTC. The pending. Hi-Tech's sales, meanwhile, soared from $1 mi 2001 to $12.7 million in 2004, court records show.

The government claims that Brady had marketed som via Web sites, and Wheat allegedly followed suit in 20 ing the Internet, they could more easily sell their ware anywhere, although it is illegal to import prescriptior into the U.S. without FDA approval. Wheat registered a s company called Hi-Tech Pharmaceuticals Ltd. and anot poration in Belize, according to documents reviewed by *B Week*. Prosecutors say the firms operated from the white house near the Central American country's Caribbean bea woman named Michele Young worked as the day-to-day tions manager, processing orders, sorting pills, and pur the rights to Web site domain names, according to the c

roducing Chase Freedom. It's the only card that lets you choose h or choose points and change back without losing a thing. oose to earn 3% cash back or points for travel, electronics, and certificates with everyday qualifying purchases. There's no ual fee. No charge for changing. Call 800-UCHOOSE or visit se.com/freedom YOUR CHOICE. YOUR CHASE

indictment and other court documents. Wheat's lawyers say, however, that he and his companies had nothing to do with any illegal activity there.

Unlike many Web pharmacies, which subcontract pill production to manufacturers in India or China, the Belize operation made pills itself, using the lightly regulated market in active pharmaceutical ingredients, or APIs, prosecutors say. The organization allegedly obtained some of its ingredients from China by way of a Montvale (N.J.) broker called New Chemic Inc. From 2002 through 2004, New Chemic shipped APIs worth more than $580,000 to Belize to make versions of Ambien, Lipitor, Celebrex, and other drugs, according to the DEA affidavit. Gregory J. Rummo, New Chemic's CEO, confirms in an interview that his company sold APIs to Wheat. Rummo says that Wheat claimed "he was not selling into the U.S." When Rummo grew uneasy about this issue in 2004, he adds, he ended sales to Wheat. Nirmal Jhunjhunwala, president of another Wheat supplier, RIA International of Whippany, N.J., says that he always obeyed the law and that he had no obligation to vet his onetime customer: "We ship you the product, and what you do with it is your problem, not ours."

Schmidt, who suffered brain damage, compares online pill-buying to Russian roulette

Spam for one of the Web sites the indictment links to Wheat, www.canadiangenerics.com, caught the eye of Gary B. two years ago. (He requested that his last name not be used.) The 50-year-old salesman from a small town in northern Georgia clicked on a link offering "generic Viagra" at a 50% discount. The site pledged that its product was safe because it was imported directly from the government-subsidized health system in Canada. He bought 120 tablets for $191.95. "I didn't have to talk to my doctor, and I didn't have to talk to my health insurer," he says. He admits he was worried when the round blue pills arrived in the mail. They were wedged loosely between two pieces of ordinary paper crudely glued together. But he was eager to surprise his wife, so he went ahead and swallowed several tablets one night when their two teenagers were out of the house. only effect was his promptly becon nauseated—and very scared. "I disc ed the rest after that," he says. "I di know what the hell I was taking."

In the house in Belize, workers n pills under primitive conditions prosecutors allege were unsanitary vestigators found what they say is a ipe for 20,000 Viagra tablets writte Wheat's scribbled handwriting. Ste D. Smith, a company vice-president, photographed by colleagues mixing ingredients in a large bowl while dre in Bermuda shorts and a gray sleev Old Navy T-shirt, according to cour timony. In the photo, Smith is we yellow rubber gloves and a gas n Charged in the Atlanta criminal cas has pled not guilty to 41 counts. H torney, Brett Bloomston, confirmed Smith in the photo but declined fu comment. Photos of the inside o house taken later by the DEA show the gray plastic ga bins labeled "Lipitor" and "Viagra" that were used to thousands of pills. Blister packs of white, yellow, or pink, green, blue, and black pills were taped next to a pr list. Fine white dust covered everything.

Among some people affiliated with Hi-Tech there see have been concern about getting caught. In an instant-me exchange in 2003, Sergio Oliveira, a company sales repre tive in Atlanta, warned Belize-based Michele Young to be c what she said online. "michele, you have to assume that a here in the [U.S.] could be working with the govt or cou gin doing so if they got in trouble down the road with products," Oliveira wrote, apparently referring to the W planetpharmacy.bz. Oliveira has pleaded not guilty to 41 nal counts in federal court in Atlanta. His lawyer decli comment. Young has been charged in the case but has tered a plea. She is believed to still be in Belize. Neither s planetpharmacy.bz responded to requests for comment.

In 2004, the FDA and DEA were growing more con

What's in the Drugs?

Some pharmaceuticals purchased online are very close imitations of brand name drugs, while others contain little or none of the expected active ingredients. Examples obtained and tested by *BusinessWeek* or the government:

MARKETER*	PRODUCT DESCRIPTION	OBTAINED BY	CONTENT
INTERNATIONAL LEGAL RX MEDICATIONS (www.faciledif.com)	"Xanax" anti-anxiety medication	*BusinessWeek*	**NO ACTIVE INGREDIENTS**
US DRUGS (www.superingsite.com)	"Lipitor" cholesterol drug	*BusinessWeek*	**NO ACTIVE INGREDIENTS**
PHOENIX AVATAR (supplier to Web sites)	"Kamagra" (generic Viagra); "Apcalis" (generic Cialis, also an erectile-dysfunction drug)	Food & Drug Administration	**HIGH-QUALITY,** contains exp ingredients

*Contacted for comment, the marketers either declined to discuss their businesses or failed to respond to questions.

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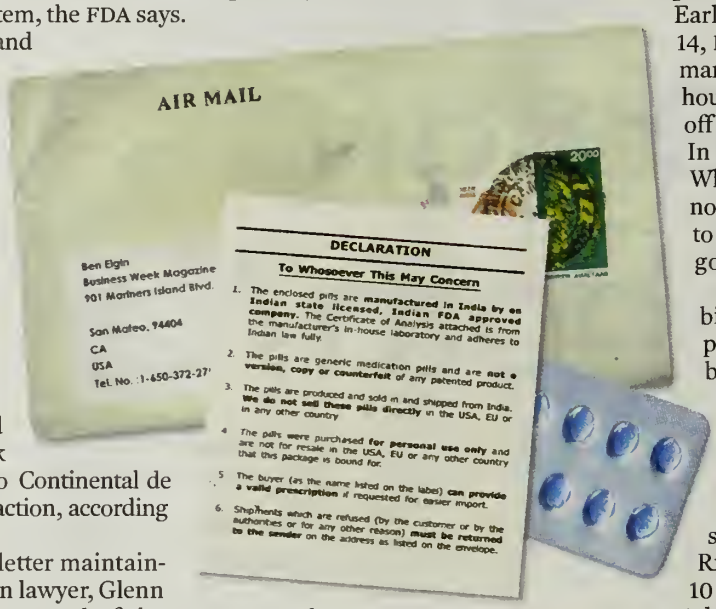
Hi-Tech Pharmaceuticals still sells to BIG CHAINS like Wal-Mart, CVS, and Kroger, even though its founder faces 20 years in prison if convicted. Its mos popular product, A SEXUAL STIMULANT, continues to be under FDA scrutir

about pharmacy Web sites in general and about sites the government connected to Wheat in particular. The FDA purchased knockoffs from a site affiliated with Wheat, according to the DEA affidavit. Tests showed that fake Ambien the FDA bought contained as much as 170% of the prescribed amount of its active ingredient, zolpidem. Such a high level can dangerously depress the central nervous system, the FDA says.

In July, 2004, Belizean police and U.S. DEA agents raided the white-walled house. Authorities in Belize charged Wheat, three other individuals, and three companies with "drug trafficking, money laundering, and preparation for crime," according to the Belize Judicial District. That month, U.S. prosecutors say, Wheat fled to Mexico and Panama to avoid appearing in court. Records in federal court in Atlanta show that on Sept. 17, 2004, he transferred $1.7 million from a Belize bank account to a new one at Banco Continental de Panamá—an above-board transaction, according to Wheat's attorneys.

After the raid, Wheat sent a letter maintaining his innocence to his Belizean lawyer, Glenn D. Godfrey, a former attorney general of that country and former member of its Parliament. Wheat then appeared to offer the lawyer a share of the pillmaking business in return for Godfrey's using his sway with local politicians. "If you would like to buy more shares it is fine with me but I will give you 10% for free," Wheat wrote. "But I need your help with the Prime Minister or whomever to get rid of these charges so we can make some money." Wheat didn't show up in court in Belize, and in March, 2005, officials there issued a certificate of acquittal and withdrew all criminal charges against him. Neither Godfrey nor Belizean law enforcement officials responded to requests for comment.



This batch of imitation Viagra came from a Web pharmacy

As U.S. law enforcement closed in this summer, Wh neighbors in suburban Atlanta observed him frequently ing on a cell phone in front of his gray stucco house. speculated that he might have been trying to avoid some of surveillance. Wheat told one neighbor that he once tra to Belize because the U.S. government was out to get Early on the morning of 14, DEA agents made his n mare come true. They raide house, arrested him, and c off his Maserati Quattro In their written stater Wheat's lawyers say: "I not been Mr. Wheat's pr to hide from the United S government."

Even as he faces the p bility of more than 20 ye prison if convicted, Wl business continues to tion. As of late No ber, Wal-Mart, CVS Kroger were all ca Hi-Tech Pharmaceu most popular produc sexual stimulant Sta Rx. The blue-diamond p 10 can be had for $14.99 Atlanta Kroger—are entir gal. The big retail chains they believe Hi-Tech is co ing with an earlier FDA co decree that required a recall of some batches of Stami because it allegedly contained the active ingredient Lilly & Co.'s impotence drug Cialis. Hi-Tech hasn't ad liability or that Stamina-Rx has ever contained that in ent. The FDA says it is "still looking into" Stamina-Rx.

Asked about the pending criminal case, CVS say monitoring the situation; Kroger and Wal-Mart decli comment. ■

–With Keith Epstein in Wash and Susan Zegel in Ne

BIG BOX CUSTOMERS

DESPITE THE MOUNTING legal peril, the Belize operation continued to pump out pills, according to U.S. prosecutors. In February, Wheat's associate, Smith, signed a purchase order for 5,000 kilograms of the appetite suppressant ephedrine and an additional 2,500 kilograms of the decongestant pseudoephedrine from an Indian manufacturer, according to court documents. The products were to be shipped to the house in Belize. But Indian customs officials, wary of such a large order, notified the DEA. The DEA, in turn, obtained a letter dated Apr. 21, 2006, signed "Jared Wheat," that urged his Indian supplier to get moving "or else we shall purchase from China, who already has our export permit verified," according to court documents.

Digital Drugs

One man's story: To learn more about Craig Schmidt, who fell victim to questionable Web medicine, watch our weekly TV show, *BusinessWeek Weekend*. Check local listings or go to businessweekweekend.com.

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I Can't Believe They Took the Whole Tea

Recruiters aren't just poaching stars. Now, nabbing groups of employees is on the rise

BY JENA McGREGOR

SOME MANAGERS RECRUIT talent one person at a time. Mark Metz hires en masse. In 2001, Metz, the chief executive of Optimus Solutions, a Norcross (Ga.) outfit that sells and services corporate computer systems, recruited a team of 10 people from a local information technology consulting firm. Two years ago, after luring a manager at a network equipment provider, Metz went on to hire the manager's 30-person team in one swoop.

This team strategy has been of Optimus since Day One. With hours of leaving his former em Metz brought on board seven form leagues to help start the new co While that left him mired in a tw legal struggle that ended in a ment and gave him pause in rec the next two teams, it didn't sto Metz knew from experience that ing whole teams could help him r a new business line—IT consultin forge a new relationship with provider much faster than if he o poached the group's leader. "You

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dynamics of a functioning team without having to create that yourself," says Metz.

Although some may call Metz's tactics little more than employee raids, executive recruiters like to call them "lift-outs," or the practice of a company hiring a whole group of employees from another outfit. Unlike a traditional corporate acquisition, in which companies often find themselves buying superfluous assets to get a few prized divisions, lift-outs offer a way to pluck a high-performing team that can quickly develop a specialized business niche or enter a new market. In a way, lift-outs are the iTunes of the merger world: Why buy the whole CD when all you really want are its greatest hits?

While lift-outs have been common in such industries as financial services and law, the practice of snatching plug-and-play teams has been expanding into different fields. Professional services firms, such as management consulting and accounting shops, are seeing a rise in the hiring of teams, say some executive recruiters. And while it's rare so far, the practice has popped up among apparel manufacturers, software outfits, and medical firms, too. "We've even seen it happen between recruiters, which has its own irony," says Newton (Mass.) employment law attorney Steven L. Manchel. Even in fields where they have long existed, lift-outs are growing.

What's causing the rise of team recruiting? For one thing, speed: The desire to ramp up a new area of business or quickly enter an unknown locale in today's hypercompetitive environment makes the concept attractive. A surge in mergers and acquisitions could be playing a role, too, putting teams in play as part of the management shuffles that deals typically trigger. Some see private equity investors as a factor because these firms hunt for money management teams with ready-made records. Or they hire away partial management teams to run the companies they have bought, says Bob Damon, Korn/Ferry International's president of North America.

When done well, lift-outs can pack a powerful punch. There's no denying the intangible value of team chemistry that doesn't have to be developed from scratch. Such cohesive units can hit the ground running and quickly find scale in new business lines. And lift-outs can also prompt customers who had relationships with departing team members to eventually follow them, too.

That, of course, is just one reason lift-outs are controversial and face legal obstacles in most companies and industries. Noncompete agreements, naturally, can make the practice a nonstarter. More common, says Garry Mathiason, a senior partner at employment law firm Littler Mendelson, are agreements that try to prevent decamped leaders from poaching their former colleagues.

Even when clear-cut written res tions aren't in place, lift-outs can afoul of the law, especially if the g is seen as unfairly competing with former employer, competing even b jumping ship, or as using confide information or trade secrets. That's the practice is pretty rare in pro focused companies, where there's intellectual property involved. "You to look at whether there are any real problems like someone comi and arguing antitrust or predatory ings," says Littler's Mathiason. " states have some kind of structure would prevent something that w destroy another party's business."

Still, plenty of lift-outs do pro and the challenges of ing them work go far be the legal issues. Some biggest problems, says Groysberg, an assistant fessor at Harvard Bus School who recently pleted a study on lif published in the *Ha Business Review*, occur early "courtship" stag a lift-out. "Firms have very clear about their tations" right from the says Groysberg.

Another potential lem: Close-knit teams try to lobby in unison joining a new firm. Afte recruited one of his to Optimus, the emp started trying to negotia group. They wanted th benefits they had at th mer employer, such a days that carried into th year. The team membe e-mails to Metz compl about it, all on the san "You think you're just many people, but they turn int acquisitions," says Metz.

Executives contemplating a should also bear in mind that br in a group of people who weren't loyal soldiers carries risks. If they a good fit with the firm's culture efforts aren't made to integrat once they get there, they could b in no time. "It's kind of like hav affair with a married woman, Brian M. Sullivan, CEO of execu cruitment firm Christian & Timb you marry her, remember she on her ex. So don't be surprise cheats on you."

PLAYBOOK: BEST-PRACTICE IDEAS

Ready For **Lift-Outs?**

The practice of recruiting whole teams is expanding. Here's what to remember when doing it:

EXAMINE CULTURAL FIT

Executives who have recruited whole teams say incoming people often try to import their old company's practices. In a lift-out, the need for people who mesh with your company's culture is compounded.

CONSULT YOUR LAWYER

Lift-outs are complex procedures and raise a host of legal issues, such as violating noncompete clauses or unfair competition. Companies who do try them should involve counsel at the earliest possible stage.

OFFER MORE THAN MONEY

Recruiting a high-performance team is tricky. Groups that are worth the effort are usually already getting plenty of bucks. They'll be looking for something else: a broader platform for expansion, say, or a more senior role. Give it to them.

PREPARE THE TROOPS

When hotshots from the outside come waltzing into a new company, existing employees may feel anxious. Managers need to reassure current employees of their value once the move becomes public.

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Boeing and Labor: Frayed Relations

As the company prepares to build a vital new plane, it faces a divided union

BY STANLEY HOLMES

IN JANUARY, MARK BLONDIN, chief of Boeing's largest union, will go before a jury to answer charges that he was drunk when his Chrysler 300 slammed into a Toyota Camry on Interstate 90, east of Seattle. The accident, which happened under clear skies at 7 p.m. on Dec. 19, 2005, destroyed both cars, and sent the other driver, retired nurse Mitchell J. Alexander, to the hospital with a serious head injury. Blondin, who has pleaded not guilty to criminal charges of drunk and reckless driving, escaped serious injury and returned to his job.

No one will be watching the ceedings more closely than Boein Blondin's union rivals. As Boeing pares to build the 787 Dreamlin most important passenger plane in the company needs to repair a f relationship with the Internation sociation of Machinists. Inside the u meanwhile, Blondin's leadership prompted sniping from critics wh he hasn't done enough to bring D 751 into the modern era.

Blondin would not comment fo story, but through a spokespers denied that he has held the union b Blondin is found guilty, he may be to step aside. That could open the w new leadership at the Machinists two sides gear up to negotiate a ne tract that must be signed in 2008.

If ever there was a time to rethin tions between Boeing and the Mach it's now. Beginning in 2008, Boei start building the 787, whose radi sign requires an overhaul of the ma turing process. At the same time, B has a record number of orders. C them built on schedule require ramp up its ambitious "lean manufacturing" program, where planes are cranked out at a faster pace as workers reduce assembly line waste and duplication. Who better than a Machinist to help advise the company on how to achieve this and, in doing so, make the job relevant for the 21st century?

BLONDIN begins ir left, at a Boeing r

Although Blondin denies it, union insiders say he has been slow to embra manufacturing. It's true the cost would kill some jobs. But critics the union say it would also cre ones, because when the compa costs, it can sell more planes fo money and hire more workers. Bl critics say the leadership in Se overly focused on restrictive wo that, among other things, prevent from putting workers where they needed. "We need a long-term st says one union member, who sp condition of anonymity. "I'm goir lean meetings because no one els to go. We need to understand thi

Blondin's ascent in 2001 can a post-September 11 slump, wh ing laid off 30,000 people. He h built the district membership

),000 from 14,000—thanks in part to ng's resurgence. And he won a better act than Boeing was offering—though vithout a 28-day strike. "He's done a good job," says Rick Bender, president e Washington State Labor Council. k wants to see Boeing succeed, and ants to make sure his members get a hake."

BLOOD

UNION CRITICS say members who ree with Blondin's priorities don't ar. "Blondin is a throwback to the ı's good-old-boy structure," says Dalay, a self-styled union reformer who o Blondin during the 2001 election. ; more interested in perpetuating his cal clique." After the last election, filed a complaint with the Labor , alleging Blondin's team violated laws to get him elected. Among the ations: that Blondin allies threatened voke shop stewards' badges if they orted rival candidates. At the time, lin denied the allegations. The government launched an investigation, found icient evidence to nullify the results, ismissed the charges. Meanwhile, in Jovember, the district's comptroller, d Abhold, abruptly resigned. Abhold Blondin asked him to violate budget that he refused to do so, and that as then forced out. The union says Abhold was not ousted and denies d's allegation.

eing declined to talk about Blondin, nsiders say the company is divided ow to deal with the union. The Chica- retains some of the antagonism from ays of former CEO Harry C. Stonecithese people say, while the commerane division wants to reach out. That be easy. During the past two contract iations, in 2002 and 2005, Boeing l hardball. At the height of the negoıs in 2002, say people familiar with atter, relations between Blondin and g's then-labor relations chief, Jerry houn, became increasingly strained. ad blood spilled into 2005, when the fused to talk most of the time, say the sources. This stubbornness, they add, much to blame for the strike as were nces over the contract.

ations between Boeing and the Mas may hang on the outcome of the While Boeing declined comment, it's he company wouldn't miss Blondin e forced out. Then again, union insay there's no obvious replacement. adds up to more uncertainty for ; just as it's riding its biggest recova generation.

'tis the season to enjoy something unusual.

Strawberry Jive

INGREDIENTS

2 oz. Hendrick's Gin
2 basil leaves
4 mint leaves and a mint sprig
2 strawberries
¾ oz. simple syrup
a couple dashes fresh lemon juice
1 oz. fresh orange juice

PREPARATION

Muddle the mint, strawberries and basil leaves in the bottom of a mixing glass with the syrup. Add the remaining ingredients except the mint sprig garnish and shake well with ice. Strain into an ice-filled rocks glass. Garnish with mint sprig.

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How Guess Got Its Groove Back

More stores and an aggressive upscale push have it strutting the fashion runway

BY CHRISTOPHER PALMERI

IN HIS TWENTY-FIVE YEARS AS chief image guru at the fashion label Guess? Inc., Paul Marciano has turned a number of pretty women into supermodels. There was the German beauty, Claudia Schiffer, who became a staple of black-and-white Guess magazine ads in the late 1980s. And there was the voluptuous Texas waitress, Vickie Smith. Marciano says he suggested she use the name Anna Nicole. He was less successful in trading on the already white-hot celebrity of Paris Hilton, who was featured in a series of Guess ads two years ago but left to pursue an acting career. "The Guess girl is edgy, sexy, confident," he says. "And she loves to be looked at."

But Marciano's greatest makeover is the one he and his brother Maurice have pulled off at Guess. Just a few years ago the company seemed like a fashion victim. The baggy urban look had taken over the jeans business. Department stores, struggling to compete with discounters such as Kohl's and Target, began pushing established brands such as Polo Ralph Lauren, Calvin Klein, and Guess to sell their jeans for lower prices. Average prices tumbled from $68 to $29. Guess sales fell 14% in 2002, and it reported an $11 million loss. "It was the darkest days of the denim business," Paul Marciano says.

Rather than continue lowering prices and diluting the brand, the brothers took their signature Euro-trendy look more upscale, shifting their denim sources from the U.S. to the finer weaves of Italy and Japan. They had their pants stitched and washed in smaller batches, often at high-cost U.S. facilities. And they opened more Guess stores. There are 706 of them now, up from 118 in 2001, and there may be 150 more in 2007, one-third of them in the U.S. The average price of women's jeans at Guess stores has climbed to $103, twice what it was a few years ago. "We had no resistance from the customer," Maurice says. "They understood they were paying more for quality."

The company's financials now look as sexy as one of Paul's model discoveries. Sales have doubled since 2002, to an estimated $1.2 billion this year, even though the Guess wholesale departm store business is just a third of wh was at its peak. Profits have come b to an estimated $110 million for 2 And Guess stock has shot up sevent fold, to a recent 65, helping it lan *BusinessWeek*'s annual list of the 100 est-growing small companies.

Opening stores gave the Marci an opportunity to feature more G merchandise. Instead of being lin to a wall of jeans and a couple of 1 of shirts at Bloomingdale's, Guess s showcase its watches, shoes, handl and fragrances. The stores also ma easier for the brothers to launch la such as Marciano, a higher-end clot line for women that makes up a thi sales at some locations. Next yea company is rolling out a new G by (concept with 30 stores. Jeans prices will top out at $65 a pair.

A PIECE OF THE RETAIL MARKUP

OVERSEAS, THE COMPANY has 37 cations. But lately the Marcianos been buying back licensing agree they had with foreign distributors s can capture more of the retail m for themselves. In Europe in parti this translates into much larger rev because the Guess brand was trad ally sold in fancy specialty stores prices on jeans average $168.

Europe is a journey home fo Marcianos, who got their start i 1970s operating retail shops i south of France. Their first Guess uct was skinny, stone-washed with zippers at the ends of th For years the Marcianos b the Nakash brothers, found Jordache Jeans and early investors, for control of the pany. The Marcianos won an the company public in 1996.

Today, Maurice an share the tit chairman an executive. M handles ope and design; runs mar Sometimes quarrel abo a particula to shoot take place Brazil and nearby But these days t to solve their ov putes—and no o really has a say.

MAURICE AND PAUL The Marcianos' move to finer denims from Japan and Italy paid off

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Steamed Over Sweatshops

Our probe of Chinese working conditions unleashes fury—and ideas for reform

ETE ENGARDIO

Many major American retail chains and brand-name manufacturers have answered criticism that they exploit "sweatshop" labor by adopting codes of conduct and on-site monitoring of their Chinese suppliers. But a *BusinessWeek* investigation found that a, many factories have just improved their skill at concealing . Our Nov. 27 Cover Story, "Secrets, Lies, and Sweatshops," d that numerous Chinese factories keep fake books to fool inspectors and distribute scripts for employees to recite if they stioned. Local consultants have surfaced to assist suppliers in auditors and undermining codes of conduct.

The article provoked an avalanche of reader responses from the U.S. and Asia and stirred discussion on blog sites. Some readers sharply criticized China and U.S. importers. Others argued that Chinese laborers are happy to have jobs fueled by Western demand, even if the hours are long, the pay insufficient, and the conditions unpleasant.

Of the businesspeople and officials with nongovernmental organizations who wrote, most agreed that auditing has failed to detect abuses. Some blame U.S. companies for imposing tough demands on factories, both to cut costs and comply with Western overtime pay standards. Other readers proposed ways to improve conditions. Here are edited excerpts:

> tory managers in na complain that U.S. e pressure creates werful incentive to at on labor standards American companies mote as a badge of onsible capitalism.
>
> —*from "Secrets, Lies, and Sweatshops"*

ghtful article on sweatshop labor exposed a major ethical dilemma consumers and businesses S. would prefer to ignore. gly low prices on consumer st us dearly in terms of their n our fellow human beings. Yellow Label Kids is one of a growing number of U.S. companies that has committed to purchasing products exclusively through Fair Trade certified suppliers. Significant change will only come about in the marketplace when consumers demand it on a large scale.

>*Hillary Sciarillo, Yellow Label Kids, San Rafael, Calif.*

Do you honestly think U.S.-based companies really want to know all of the details of the operations they purchase from? They want someone to paint a pretty picture for them that they can hide behind, later claiming no knowledge or ownership in the abuses.

>*Scott Macdonald, Maryland Thermoform Corp., Baltimore*

It's unfair to neglect to mention the factories such as ours that operate in China but are not involved in any of the practices you described. We do not give in, at the expense of our employees' welfare, to excessive demands of the retailers mentioned in your article. Our customers respect our quality and know that we maintain high business standards to achieve this quality.

>*Harold J. Fischel, Vanguard (USA) Inc., Whitmore Lake, Mich.*

I am a manager of a China audit team, and this article sums up very nicely what we deal with every day. The reality is that our work is about creating awareness of the importance to improve labor conditions step by step, and this has been successful. But to expect [Chinese factories] to meet the ideal is impractical, unrealistic, and naively Western. When the local government sets the minimum wage at $75 per month, it doesn't expect the factories to comply. They expect the factories will make an effort to stop paying $50 and get closer to $60. American companies must understand this process and allow for continuous improvement. They must stop trying to bully Chinese factories.

>*Screen name: Mr. Wong (businessweek.com)*

It seems that the problem could easily be solved by companies like Nike paying enough so that factories could afford 50¢ per hour instead of 42¢. That would add less than a dollar to a pair of $100 Nike shoes. Are we Western consumers so cheap that we're willing to accept unethical factory conditions to save a dollar here and there?

>*Screen name: Rich American (businessweek.com)*

The fact that [Chinese workers] are so complicit in helping to hide oppressive conditions from auditors indicates they're tickled pink to have their sweatshop jobs.

> Many Chinese laborers, especially migrants from poor rural regions, still seek to work as many hours as possible, regardless of whether they are properly paid.
>
> *—from "Secrets, Lies, and Sweatshops"*

They'd be far worse off if Nike bowed to public pressure and moved their contracts to Bangladesh. We'll approach [wage] parity when high demand for Chinese products results in their wages being bid up. If you want to accelerate this process, insist on buying Chinese.

>*Screen name: Rational Bloke (businessweek.com)*

As a Chinese who grew up in China, worked in China for several years, and came to the U.S. to pursue an MBA until I was 29, I saw how both systems work. I have seen most of the things the authors describe. However, we need to seriously consider whether U.S. companies are really willing to enforce their Western-style rules on their cheap suppliers. One of the obvious solutions is to increase prices paid to vendors. But no one can afford to do that, since most U.S. companies compete based on lower prices. This is a story of cheating and self-cheating. Second, are Chinese local governments willing to enforce many labor rules? These factories are the backbones of local Chinese economies.

>*Screen name: Truth (businessweek.com)*

What the *BusinessWeek* report says is true. Most Chinese factories have just gotten better at concealment. My previous company in China supplies a big U.S. cell-phone company in China. The cell-phone company's quarterly [requirement to reduce costs] is a killer.

>*Screen name: Al (businessweek.com)*

Your Nov. 27 Cover Story highlights precisely what organizations concerned with workers' rights have long argued: that relying exclusively on codes of conduct and auditing has only limited effectiveness. As our recent report, "Offside! Labor Rights in Sportswear Production in Asia," points out, a further step is to prioritize contracts with factories that are unionized. Workers themselves, organized into democratic trade unions, are in the best position to monitor and influence labor conditions in their workplaces. Businesses should

> Conceding that the current system is failing to stop widespread abuses, more and more American companies are experimenting with new ways to enforce lab standards.
>
> *—from "Secrets, L and Sweatsho*

recognize this as key to their own success, as improving livelihoods to contributes to making consumers stronger tomorrow.

>*Raymond C. Offenheiser, Oxfam A*

How about creating a central rating system for Chinese, Indian, Eastern European, and Latin American vendors, like the credit score syste Preferably, one or more global audi agencies could take this up. This w have commensurate rewards and punishments for vendors, and the could be broadened from labor to parameters. It would help people g a decent chance as well as reduce problem of coordination. Vendors good score could even charge a pr

>*Screen name: Onk (businessw*

As a graduate student in a Chines city university, I think the article is Actually, the situation is more seri Work conditions in sweatshops ar and poor; employees are underpai central government should take m to protect the disadvantaged, and international community should p Chinese government to protect th of poor workers.

>*Screen name: fanzh (business*

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New super yeast can ferment more kinds of sugars

Put a Termite In Your Tank

Bio breakthroughs are promising much better ways to make ethanol

Researchers are hoping to mimic the termite's digestive powers

BY JOHN CAREY AND ADAM ASTON

MARK EMALFARB didn't set out to cure America's addiction to oil. He just wanted a better enzyme to soften blue jeans. The search led him to a new fungus in the wilds of eastern Russia, and then to a serendipitous mutation that turned the organism into a biofactory capable of churning out vast amounts of enzymes that can give denim a prized lived-in look. "By accident, we came by the world's most prolific fungus," he says.

That fungus and its talent for munching on plant fiber is now helping to bring about a radical transformation: a switch from oil and gasoline to fuels from plants. On Nov. 2, Emalfarb's company, Dyadic International Inc. in Jupiter, Fla., signed a deal with Spanish energy giant Abengoa to use the fungus to make fuel. A pilot facility is being built in Nebraska. In contrast to traditional corn-based ethanol, the raw material is agricultural waste. Such facilities can run on cornstalks, straw, wood, wastepaper, and just about any other material rich in cellulose.

Experiments like this one come at a critical juncture. Corn ethanol factories are springing up across the U.S., in part because of billions of dollars in subsidies. But the dirty little secret is that it takes the energy equivalent of about 7 gallons of gasoline to make just 10 gallons of corn ethanol. Moreover, farmers figure that the most the U.S. could produce without sending corn prices soaring is about 14 billion gallons a year, up from nearly 5 billion in 2006. As the public grows more aware of these shortcomings, some critics are questioning the entire category of plant-based fuels.

Engineered *E. coli* ferments faster

Yet if efforts such as Abengoa's can be scaled up efficiently, America's forests, agricultural waste, and 40 to 60 million acres of prairie grass could supply 100 billion gallons or more of fuel per year—while slashing greenhouse gas emissions. That would replace more than half the 150 billion gallons of gasoline now used annually, greatly reducing oil imports. It "will happen much faster than most people think," predicts Michigan State biochemical engineer Bruce E. Dale. "And it will be enormous, remaking our national energy policy and transforming agriculture."

That's why, despite skepticism in certain quarters, cellulose-based biofuels have become the darling of an unlikely coalition of national security hawks, environmentalists, venture capitalists, and

Grasses are plentiful, but so far are costlier to turn into ethanol than corn is

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or companies such as Dupont and BP Dupont is teaming up with ethanol ucer Broin on a pilot plant in Iowa with BP to make another fuel called nol. "Every Monday, I wake up and c I have an idea of how big this is," John Pierce, vice-president for bio- l technology at Dupont. "By the of the day, I have to reca- e upward." In Jennings, Celunol is about to open pigot on the first drop anol from sugarcane . And Canada's Io- Corp. is planning a cale plant to pro- millions of gal- of ethanol from t straw.

king fuel from osic plant mate- s more compli- and costly than cing ethanol corn, but an on- wave of discovery novation is chang- at. Researchers are nizing each step in the , from source crops to es and yeasts hand-tai- to break apart plant fibers onvert them into alcohol. Scientists are scouring China rains of tall grasses and ng with plants' genes to make energy crops. They are collecting es in Costa Rica, hoping to harness gs' ability to digest cellulose. Sev- oups have studied a fungus discov- uring World War II that ate up the cotton tents. Richard Hamilton, f Thousand Oaks (Calif.)-based Inc., compares the progress to TV s' struggle to perfect flat-panel s. The first few factories "will be ful expensive, but we're early on ning curve. We've only scratched face of what a lot of us think is e," he says.

s is one of several companies ng for the right crops. Two can- are switchgrass, which once car- J.S. prairies, and an Asian grass niscanthas. Both are perennials, ers would have to do little more rvest them. The plants' deep roots e the soil while storing carbon to global warming. In such grasses, ources like wood, the energy is up in cellulose and a similar ce called hemicellulose, which r constitute 70% to 85% of the he first trick is softening up the plant to make the cellulose easier to digest. Michigan State's Dale has invented a promising approach a bit like using a spritz of hot, pressurized ammonia.

The next challenge is breaking apart the chains of sugar molecules that make up cellulose. That's where enzymes from fungi, the guts of termites, or the labs of genetic engineers come in. Recent work has lowered the cost of this step thirtyfold, to about 50¢ per gallon of ethanol produced. "We now are not far away from the goal of 10¢ per gallon," says Glenn E. Nedwin, chief scientific officer at Dyadic.

Agricultural waste could yield billions of gallons of fuel

The last task is one familiar to moonshiners: fermenting the sugar into alcohol. The twist is that the sugars from cellulose and hemicellulose are different, so scientists are creating more talented fermenting organisms, such as genetically engineered *E. coli*, to handle the added complexity. "That problem is close to solved," says Lee R. Lynd, a professor at Dartmouth and chief scientific officer of venture capital-backed Mascoma Corp. in Cambridge, Mass.

Lynd and Mascoma, however, are dreaming bigger. They have coaxed microorganisms to digest cellulose and ferment the resulting sugar in one bubbling cauldron, instead of in two separate steps. If the system pans out, "it is a game-changer. It will revolutionize the industry," says Lynd. On Nov. 29 the company announced a deal with Tamarack Energy Inc. to develop pilot plants.

Whatever the process, there's no need to stop with ethanol, adds Stanford University biologist Chris Somerville. Butanol and other substances more similar to gasoline offer certain advantages over ethanol. For investors, the beauty is that any of these approaches can piggyback on the corn ethanol infrastructure. "If we did not have corn ethanol priming the pump, it would be too risky for me to invest in cellulosic ethanol," says venture capitalist Vinod Khosla.

Will the road to the future be powered by biofuels? The technology is there. So are the incentives, with oil prices expected to be above $70 per barrel in 2007. "This will absolutely change the way we power our automobiles," says Hamilton. ■

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HEALTH

HOMING IN ON THE MAGIC IN RED WINE

IT'S BEEN A GOOD year for resveratrol. Scientists have hailed this substance in red wine as the magic element that enables French people to stay heart-healthy despite their rich diet. But investigators may be celebrating the wrong molecule.

Credit should go not to resveratrol but to compounds in grapes called procyanidins, say the authors of a paper in the Nov. 30 issue of *Nature*. Part of a class of botanical compounds known as flavonoids, they're found in high concentrations in the grapes used to make red wines in southwestern France and Sardinia—regions renowned for their inhabitants' longevity. The paper's authors, from Queen Mary's School of Medicine & Dentistry in London and several other institutions, say procyanidins work by suppressing the body's synthesis of a small protein called endothelin-1, which constricts blood vessels.

–Neil Gross

HIGHWAY SAFETY

A BETTER CRASH BARRIER

LEVERAGING WORK done for NASCAR, researchers have created a highway crash barrier they say is better than today's big yellow barrels filled with sand. Made from a patented plastic, the shield springs back to its original shape when struck, so it doesn't need replacing.

NASCAR asked researchers at Battelle Science & Technology International to come up with an alternative safety cushion after star driver Dale Earnhardt was killed at the Daytona 500 in 2001. The researchers at the Columbus (Ohio) lab developed a form of polyurethane that collapses to absorb the impact of a speeding car. Because the compound's molecules remember their initial structure, the material rebounds a few minutes after the vehicle has been removed. Scientists have placed the plastic in a 25-foot-long steel case that telescopes in and out. In tests, the barrier has withstood a dozen crashes, says Scott Versluis, a Battelle commercialization manager. Battelle has submitted its NASCAR data to the Federal Highway Administration and hopes to see the barriers approved in mid-2007.

THE MILITARY

FOR GIs, A NEW EYE IN THE SKY

DRONES A LITTLE smaller than 3CPO in *Star Wars*, unlike any drone in the sky today, may soon be helping combat troops. The unmanned aircraft, recently tested with infantry units in Hawaii, are designed to fly ahead of military personnel and relay back live video or heat-tracking images.

Built from composite materials and aluminum and powered by gasoline, the 20-pound aircraft can shoot straight up on bottom-mounted fans. The drones use tilting vanes to move sideways. They can stay aloft for about 45 minutes and can fly as far as 1½ miles from their controllers on the ground. To work best, though, they need to be in the operator's line of sight, so buildings or other objects could limit their use.

Based on prototypes from Honeywell International, the drones would operate ideally at about 500 feet off the ground. They could be fielded in battle as early as 2008.

–Joseph Weber

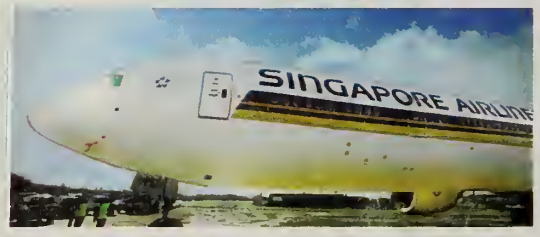
Creature Comforts At 30,000 Feet

Singapore Airlines is bucking industry trends, giving fliers on Boeing widebodies a more luxurious ride. **BY STANLEY HOLME**

CRAMMING passengers into every inch of useable space while cutting back on meals and other perks has become standard operating procedure for many carriers. Singapore Airlines is clearly flying a different route.

On Nov. 29, the carrier took delivery of the first of 18 Boeing 777-300 ERs (extended range planes) tricked out with interiors that set a new standard for creature comforts at 30,000 feet. The first-class cabin is divided into eight private mini-rooms, each with a 35-inch-wide leather seat that folds down into a full flat bed. The space, with an adjustable table and 23-in. LCD TV screen that can double as a computer monitor, is easily reconfigured for working, sleeping, or lounging. It all has a private jet feel.

Business class has more compact versions of this arrangement, with 15-in. LCD screens and slightly narrower seats that also convert to flat beds. In economy class, seats are 19 in.—vs. the industry-standard of 14 to 16 in.—and have AC power supplies and USB ports.



Passengers traveling between Paris and Singapore were the first to test the new amenities when Singapore introduced its new 777 service on that route on Dec. 5. U.S. travelers to Asia will get their first opportunity on Jan. 15, when Singapore adds another new 777 on its San Francisco-Seoul-Singapore flights. Eventually, the carrier plans to install these Givenchy-designed interiors—the haute-couture house did the pajamas and slippers, too—on all of its 48 new widebodies, including the Airbus A380 super-jumbos that are expected to take off for the first time in 2007.

Singapore Airlines executives believe business travelers will pay nearly $14,000 for a roundtrip first class Paris-Singapore ticket, or almost $9,000 for business class, to obtain such amenities. Says CEO Chew Choon Seng: "This will be a game-changer."

NO CABIN FEVER First-class fliers on Singapore's new 777s get a bed, a table, and a 23-inch TV, along with jammies they'll want to keep

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Earbuds Aren't Enough

Gift ideas for the iPod owner on your shopping list.

BY JAY GREENE

SING OUT The $50 iKaraoke filters out the vocal track (well, most of it), leaving just your marvelous pipes to belt out tunes. The music and your voice play through speakers or an FM radio. Unlike real karaoke, you need to know the lyrics. (griffintechnology.com)

BLAST IT This lipstick red Genev Lab Sound Systen Model XL matche style with functio The $1,075 XL ca pump out 600 wa of amplification, making it perhap the best-soundin iPod speaker, too The unit also has a CD slot and an FM tuner. (genevalab.com)

ROCK WHILE YOU CHOP At $100, iHome's iH3 under-the-kitchen-cabinet speaker system is a w Dock your iPod in a nifty drawer that retracts int the player, and rock on as you cook, eat, or clean sound quality is solid, if not spectacular. This is audiophile experience but a clever way to bring to a room long neglected. (ihomeaudio.com)

MUSIC MOVES YOU For $100, the iCarta Stereo Dock for iPod with Bath Tissue Holder offers solid sound. One drawback: It needs electricity, so you must have an outlet near the potty. (atechflash.com)

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The Next Wave

BY MIKE MARRONE

You'll Love These Yeah, Yeah, Yeah

AS WE CLOSE IN ON the end of another year, I want to look back at a few notable albums released in 2006 that I feel will stand the test of time.

The Beatles | Love
(Apple)
No middle ground here, Beatles fans either love or hate this set. Put me squarely in the former camp. Sir George Martin and his son Giles have lovingly created a sonic wonderland that could serve as the most compelling soundtrack to a game of Name that Tune ever created. Lifting passages and combining songs that are a part of our DNA, they have managed to make some of the most familiar music in the world sound new.

Although the Martins began working on the project in 2003, it was George Harrison's friendship with Cirque du Soleil founder Guy Laliberté that really started the ball rolling in 2000. Cirque du Soleil's "Love" show was fully endorsed by the families and surviving Beatles after three years of negotiations, and made a June 30, 2006 debut at the MGM Mirage Theatre in Las Vegas.

Love is the first Beatles music to be released in 5.1 surround sound, which is sure to be a selling point for some. The beautiful new string arrangement that Sir George wrote for *While My Guitar Gently Weeps* is magical. He used Harrison's early demo of the song (with different lyrics) and made it sound like a finished master recording. You will notice the drums are much more up front in the mix throughout, proving once and for all that Ringo is indeed one of the most underrated and inventive timekeepers in the history of rock.

Calexico | Garden Ruin
(Quarterstick Records)
Calexico, a 10-year-old Tucson collective founded by guitarist/vocalist Joey Burns and drummer John Convertino, unleashes a mind-bending blend of musical styles that touch on Ennio Morricone's spaghetti Western soundtracks, mariachi, Afro-Peruvian music, late fifties/early sixties jazz, rock, country, and everything in between.

This is easily the band's most song-centered release and the first of their five studio albums that fails to include an instrumental. Longtime fans may find that upsetting, but those just discovering the band's intoxicating blend will invariably investigate their brilliant back catalog. The environment-centered *Cruel* appeals to both camps. I also recommend *Bisbee Blue*, a love song about the place where the album was recorded, and the dramatic and inventive *All Systems Red*.

Ollabelle | Riverside Battle Songs
(Verve Forecast)
The second album from this New York band has the distinction of being pe
the greatest creative leap forward
heard between a debut effort and s
more release in at least the last dec

The band took its name from c
singer Ola Belle Reed and one
highlights of the album is a rendi
Reed's *High on a Mountain*. Anoth
version of the Nina Simone-Georg
tune *See-Line Woman*. In the end,
original material that sets this apa
the debut, and the entire band
through. Tony Leone with *Reach f*
Dream the Fall from Fiona McBai
Helm's (Levon's daughter) brilli
erything is Broken, and Amy agai
Byron Isaacs on *Northern Star*. I
Emmylou Harris, classic Little Fea
than a touch of The Band, and
Burnett as a musical starting po
mix with Appalachian gospel an
York's East Village.

Bruce Springsteen & The E Street Band | Live at the Hammersmith Odeon, London 1975
(Columbia)
Originally released as a DVD in t
anniversary *Born to Run* box set
the album to play for anyone who
quite get the power and beauty
and his band. It'
ply amazing set,
ly when you cons
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ments were bra
songs. Thankf
annoying "Broc
calls get in the
the best (nonboc
version of *Thun*
I've heard. This r
deserves a place next to the gre
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***Mike Marrone** is program director of*
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BY ROBERT PARKER

Big Wines From Adelaide's Small Player

SOME OF AUSTRALIA'S finest wines are made from old grenache and shiraz vin in wine-growing areas such as the Barossa Valley, Clare Valley, and McLare Vale that are clustered around Adelaide, South Australia's capital. It doesn't hurt that 2004 and especially 2005 might be the region's best vintages ever These cuvées begin life as if they were European wines on steroids, but the become more elegant and balanced with age. The giant Penfolds (BW—Nov. is based here, and so are some terrific boutique producers.

D'Arenberg (McLaren Vale)
Look for the inexpensive Stump Jump red and white blends, which cost about $10. The flagship shiraz, The Dead Arm, is a blockbuster red of enormous proportions and ageworthiness. The 2004 (95 points, $65) is the current release.

Greenock Creek (Barossa Valley)
It is difficult to find more thrilling, exhilarating grenache and shiraz than the single vineyard offerings from this low-key operation run by the shy and humble Michael and Annabelle Waugh. The 2003 Shiraz Creek Block (100 points, $150) is pure perfection and is even superior to the winery's $350 Roennfeldt cuvées.

Kaesler (Barossa Valley)
Shiraz Old Bastard is a fitting name for the Kaesler family's flagship cuvée—it is produced from a single vineyard planted in 1896. You should allow the 2004 vintage (95 points, $135) to get old itself, since it has the potential to age two or three decades. Other Kaesler shiraz bottlings run $27 to $65.

Kalleske (Barossa Valley)
A longtime grower recently turned winemaker and estate bottler, Troy Kalleske is one of the Barossa's up-and-comers. His 400-acre, family-owned estate is a name to follow. The 2005 Clarry's Red (89 points, $30), a blend of 80% grenache and 20% shiraz, is an A take on a Côtes du Rhône. Its top wine, Johan Georg Old Vine, comes from a 1 year-old vineyard named for the first K to emigrate to Australia.

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin board, tens of thousands of tasting notes, or to order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21111.

Kilikanoon (Barossa and Clare Valleys)
Winemaker Kevin Mitchell turns out sc the cooler-climate Clare Valley's most shiraz cuvées and the Barossa Valley's robust offerings. The 2005 Shiraz Kille Run (92 points, $20) possesses terrifi blackberry and cassis fruit and an opu personality. In fact, all the Killerman's bottlings are great values.

Rusden (Barossa Valley)
Winemaker Christian Canute, just fashioning soulful, personality-fille that start at $20. His top-of-the-lin is the 2003 Shiraz Black Guts (96 p $90). It's intense, with peppery, blac and smoky traits, and an astonishin 50-second finish.

Two Hands (Barossa Valley)
Two Hands is a négociant—it buys fr small producers, and bottles and ble own wines. It has a bevy of old vine s offerings, which run from the intense Shiraz Angel's Share (92 points, $3C spectacular 2004 Shiraz Ares (96 p $150), which is good enough to keep to 30 years.

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.c

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AAI LISTED NYSE

In Search of a Global Index Fund

None exists—yet. But Wall Street's quants are on the case. **BY CHRISTOPHER FARRELL**

IN THE LATE 1990s, AS THEY were pacing around a green room waiting to start a televised panel discussion, Nobel laureate William Sharpe and veteran Wall Street rocket scientist Martin Liebowitz got into a friendly debate. They argued about what would be an appropriate asset-allocation benchmark for a global portfolio. They didn't reach a conclusion, but both admitted that their personal investments were less international than they should be. "I think indexing the world is a nifty idea," Sharpe recently said, recalling the moment. "Unfortunately, the world market portfolio doesn't exist."

Investors can assemble a portfolio made up of exchange-traded funds and indexed mutual funds that mimic pieces of the world's stock and bond markets. Still, it would be only a crude approximation, and some important components—such as an international bond index fund—do not yet exist. But sometime in the next year or so, Wall Street's index mavens may well come up with the Holy Grail of investing—a single-purchase, low-cost, indexed global portfolio.

If such a fund could be developed, the MSCI Global Capital Markets Index could be the foundation. It's composed of publicly traded stocks and bonds —11,000 securities in all. Index designers are also trying to figure out how to fold in commodities, real estate, even private equity. "We're moving toward a global wealth portfolio," says David Darst, chief investment strategist for Morgan Stanley's Global Wealth Management Group.

A basic global portfolio would be about 60% stocks, 40% bonds, the same benchmark allocation commonly used for a U.S.-only mix. Both the stock and bond portions of a global portfolio would be about half U.S. securities. Some 85% to 90% of the remainder would be from developed markets in Europe and Japan, the rest from emerging markets such as China and India.

Does this mean U.S. investors, who have about 10% of their assets abroad now, should ramp up to 50%? In cases, no. Modern portfolio theory Sharpe is one of its founders—hold an investor should own everything i portion to its capitalization in the w markets. But most of us don't own l all over the world and consume and services from everywhere. Say Levin, a certified financial planne head of Accredited Investors in Minn.: "I still want a bias toward assets since most of my clients a spending dollars."

Then just how much should be national? Many financial adviser gest that high net worth clients to as much as 30%, which is still cal departure from the past. "Y people are more open to the idea t ternational should be a large part portfolio," says Mark Balasa, co-o finance-planning firm Balasa Dinv Foltz in Itasca, Ill. Many clients, es ly those 55 and up, are resistant see it as too risky," Balasa says.

MORE INTERTWINED

PORTFOLIO THEORY HOLDS th diversification—and you can't ge diversified than a truly global por diminishes risk and enhances How so? Markets don't move in t so if your investments in one se sagging, they may be shining som else. But in recent years, as the economies became more intertwi markets have become more corr that is, they're more likely to mo same direction at the same time.

Yet investors, even professior tend to misinterpret the relation tween correlation and the benef versification, argue Meir Statmar professor at Santa Clara Univer Jonathan Scheid of Bellatore, cial-services firm in San Jose, C recent correlation between the r U.S. and international stocks is the gap between the two is also instance, the three-year return Nov. 30) of the Vanguard Total tional Stock Index Fund is 22.6 Vanguard Total Stock Market In is 14.6%. The year-to-date gap and 14.2%, respectively. Inves concentrated their portfolios i during this period badly lagge those who diversified worldwid

If you're looking to globa portfolio now, those two Vangu would provide a good base. Th complete solution, but with a b ponent, they will suffice until finds the Holy Grail. ■

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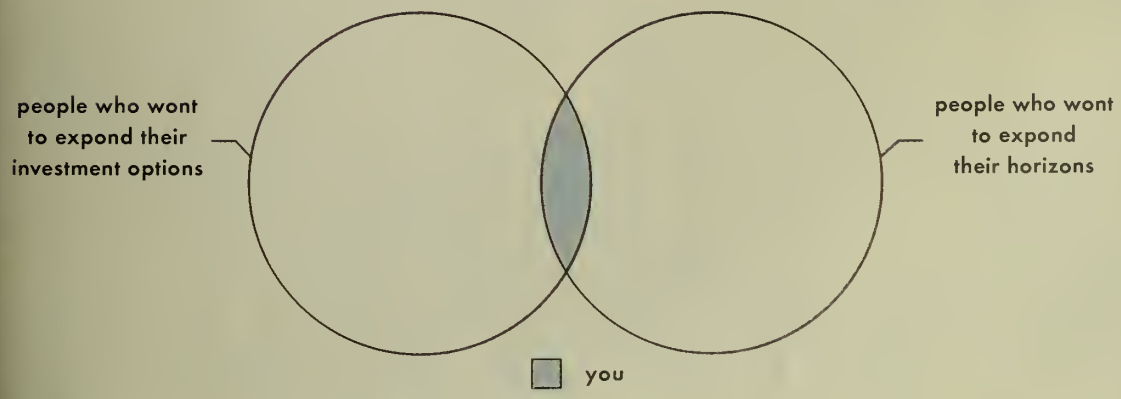
BROADENING PERSPECTIVES



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BY GENE G. MARCIAL

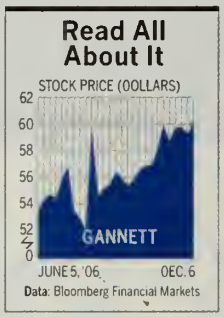
WITH SUBSTANTIAL NET HOLDINGS, GANNETT IS MAKING NEWS

A WINNING STREAK AT McAFEE SPURS TAKEOVER TALK.

THE ROLLOUT THAT HAS INTER PARFUMS SMELLING LIKE A ROSE

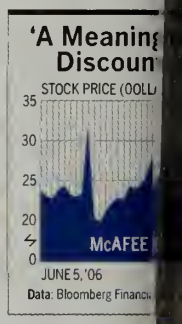
Gannett: A Headliner?

IT'S NO SECRET THAT NEWSPAPER stocks have been bad news for the market, so the Street has steered clear of the group. But Ed Walczak, managing director at Vontobel Asset Management, whose "deep-value" portfolio is 25% in cash, has acquired nearly a 2% stake in Gannett (GCI), the media giant that owns 91 U.S. daily newspapers, including *USA Today*, the largest- selling daily, and nearly 1,000 non-dailies and 23 TV stations. Gannett also owns 17 dailies and 300 non-dailies in Britain. Unlike others in its group, Gannett's stock has been on the rise since July, going from 51 to 59.60 on Dec. 6. But it's still down from its 52-week high of 65 in January and is at the low end of its historical price-earnings ratio of 11 to 26. "The stock is cheap here, and we expect it to be in the mid-70s in 12 months," Walczak says. "Gannett's the best in the industry, performing very well and generating abundant free cash flow," adds Walczak, who sees himself as a Warren Buffett-style value investor. Gannett is recapturing part of ad revenues it has lost to the Internet, he notes, from its growing online operatons. Its slim revenue growth of 2%-3% is sufficient to justify owning the stock, he adds, since a big part of that comes from online ads that he says will keep ramping up. Also vital is its 42.5% stake in CareerBuilder.com, the largest U.S. online job Web site, adds greatly to its sales growth. And it has stakes in ShopLocal.com and Topix.net. One of the two major analysts who is bullish is Steven Barlow of Prudential Equity Group, who rates Gannett "overweight," with a 12-month stock price target of 65.



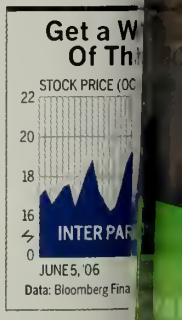
McAfee May Have to Fight 'Em Off

AS THE WORLD'S NO. 2 MAKER of anti-virus, anti-spam, and anti-spyware network software, McAfee (MFE) might also need to develop an anti-takeover shield. Chief Financial Officer Eric F. Brown told a conference on IT services in New York on Nov. 7 that McAfee wasn't for sale. But that didn't stop the buzz. "It is a potential acquisition candidate due to its cheap valuation, strong free cash-flow growth, and recent rollout of new products that are being well received," says Richard Parrower, managing director at investment firm J. & W. Seligman, which owns shares. Suitors, he adds, "could be Cisco, Hewlett-Packard, or Dell." The stock climbed from 19 in mid-August to 29 on Dec. 6. Walter Pritchard of Cowen, who tags the stock "outperform," says McAfee "remains an attractive take-out candidate." He values McAfee in a deal in the low 40s. At 9 times his estimated 2007 free cash flow, it is "trading at a meaningful discount to its peers," he notes, which trade at 11 to 16 times. Pritch forecasts profits of $1.38 a share in 2006 and $1.46 in 2



Inter Parfums: The Sweet Smell of Success

INTER PARFUMS (IPAR), which makes and markets top fragrances worldwide as a licensee of top branc including Burberry, Lanvin, and Van Cleef & Arpel upping its ante in the industry. It has signed exclusive to produce perfume and beauty products for The Gap Banana Republic. "This will be a massive new avenue that should deliver huge growth," says IPAR Chairman and CEO Jean Madar. Banana Republic's fragrance, bath, and body products were launched in September at 400 of its 503 stores. "It was better than expected in sales and brisk reorders," says Madar. The new products will be at most of Gap's 1,327 stores by March, 2007. Inter Parfums' stock rose from 15 on Sept. 1 to 20 on Dec. 6. Based on the Gap/ Banana Republic fragrance rollout and successful launches of IPAR's existing brands, Neely Tamminga of Piper Jaffray rate "outperform." She estimates earnings of 83¢ in 2006 $1.02 in 2007. Charles Glovsky of Independence Inve which owns a 7.3% stake, says its new business with retailers is "an exciting fresh growth area."



BusinessWeek.com Gene Marcial's Inside Wall Street is post at businessweek.com/investor at 5 p.m. EST on the magazine publication day, usually Thursdays.

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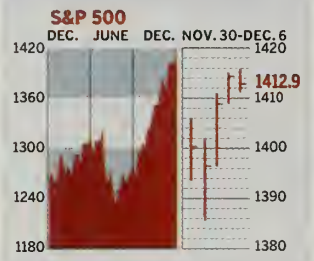


COMMENTARY

Markets made merry, with the S&P 500 hitting a six-year record before pulling back on Wednesday. Gloomy news came earlier in the week from Pfizer. The drugmaker's stock fell 8.4% after it announced it would stop testing its new cholesterol lowering drug. Good news came from Bank of New York, which rose 10.7% after agreeing to merge with Mellon Financial.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	DEC. 6	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1412.9	1.0	13.2	11.8
Dow Jones Industrials	12,309.3	0.7	14.9	13.4
NASDAQ Composite	2445.9	0.6	10.9	8.2
S&P MidCap 400	819.6	1.6	11.1	10.5
S&P SmallCap 600	406.3	1.7	15.9	12.9
DJ Wilshire 5000	14,209.3	1.1	13.7	12.4
SECTORS				
BusinessWeek 50*	802.6	1.1	8.2	4.8
BW Info Tech 100**	446.0	1.2	17.2	15.3
S&P/Citigroup Growth	654.5	0.6	9.7	8.2
S&P/Citigroup Value	756.4	1.3	16.8	15.6
S&P Energy	465.0	1.0	24.8	20.4
S&P Financials	484.6	1.2	13.6	13.3
S&P REIT	202.4	0.6	32.3	31.0
S&P Transportation	273.8	1.0	9.6	11.1
S&P Utilities	186.6	1.2	16.9	17.4
GSTI Internet	203.0	0.7	-1.1	-4.0
PSE Technology	888.3	0.9	6.2	3.8

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS	DEC. 6	WEEK	% CH YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1943.4	1.0	28.6
London (FT-SE 100)	6090.3	0.1	8.4
Paris (CAC 40)	5350.6	-0.6	13.5
Frankfurt (DAX)	6369.5	0.1	17.8
Tokyo (NIKKEI 225)	16,371.3	1.8	1.6
Hong Kong (Hang Seng)	19,026.4	1.3	27.9
Toronto (S&P/TSX Composite)	12,889.8	1.7	14.4
Mexico City (IPC)	25,615.9	3.4	43.9

FUNDAMENTALS	DEC. 5	WEEK AGO
S&P 500 Dividend Yield	1.75%	1.79%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.8	17.6
S&P 500 P/E Ratio (Next 12 mos.)*	15.3	15.0
First Call Earnings Revision*	-0.47%	-0.65%

*Fi

TECHNICAL INDICATORS	DEC. 5	WEEK AGO
S&P 500 200-day average	1307.2	1304.1
Stocks above 200-day average	76.0%	69.0%
Options: Put/call ratio	0.76	0.90
Insiders: Vickers NYSE Sell/buy ratio	6.40	5.55

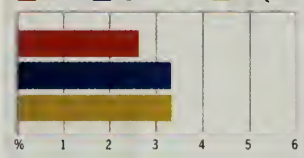
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Homebuilding	17.5	Steel	88.8
Tires & Rubber	14.6	Divsfd. Metals & Mining	51.5
Divsfd. Metals & Mining	13.3	Agricultural Products	45.0
Office REIT's	12.6	Motorcycles	41.5
Steel	11.7	Department Stores	40.2

WORST-PERFORMING GROUPS	LAST MONTH %	
Automobiles	-15.2	Education Services
Home Entertnmnt. Sftwre.	-8.7	Homebuilding
Health-Care Supplies	-6.7	Internet Software
Distillers & Vintners	-3.6	Health-Care Supplies
Health-Care Technology	-3.0	Internet Retailers

MUTUAL FUNDS

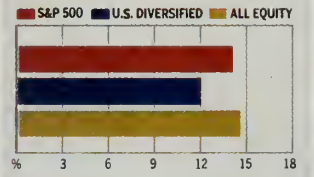
4-WEEK TOTAL RETURN

WEEK ENDED DEC. 28



52-WEEK TOTAL RETURN

WEEK ENDED DEC. 6



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Real Estate	8.1	Precious Metals	45.1
Natural Resources	7.1	Pacific/Asia ex-Japan	37.8
Precious Metals	6.9	Real Estate	35.3
Pacific/Asia ex-Japan	6.6	Latin America	34.6
LAGGARDS		**LAGGARDS**	
Health	0.0	Japan	3.7
Japan	1.1	Health	6.1
Financial	1.9	Large-cap Growth	6.6
Domestic Hybrid	2.3	Technology	7.4

EQUITY FUNDS

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
iShares DJ U.S. Home Constr.	17.8	Oberweis China Opport.	81.6
DireXn. Cmdty. Bull 2X	16.0	Dreyfus Prem. Grtr. China A	74.2
DireXn. Emrg. Mkts. Bull 2X	15.7	U.S. Global Invrs. Gold	70.8
SPDR Homebuilders ETF	14.8	U.S. Glbl. Invs. Prc. Mnls.	70.8
LAGGARDS		**LAGGARDS**	
DIreXn. Emrg. Mkts. Short	-13.8	Ameritor Investment	-87.5
ProFunds UltSh. Emrg. Mkts.	-12.6	DireXn. Emrg. Mkts. Short	-50.7
DireXn. Sm. Cap Bear 2.5X	-10.2	DireXn. Sm. Cap Bear 2.5X	-30.6
DireXn. NASDAQ 100 Bear 2.5X	-8.4	ProFds. UltSh. Sm. Cap Inv.	-25.4

INTEREST RATES

KEY RATES	DEC. 6	WEEK AGO
Money Market Funds	4.85%	4.86%
90-Day Treasury Bills	4.98	5.04
2-Year Treasury Notes	4.58	4.68
10-Year Treasury Notes	4.48	4.52
30-Year Treasury Bonds	4.60	4.61
30-Year Fixed Mortgage †	5.83	5.95

†

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
General Obligations	3.64%
Taxable Equivalent	5.20
Insured Revenue Bonds	3.74
Taxable Equivalent	5.34

THE WEEK AHEAD

INTERNATIONAL TRADE *Tuesday, Dec. 12, 8:30 a.m. EST* » The October trade deficit was likely $63.6 billion, say economists polled by Action Economics. The September gap was $64.3 billion.

FOMC MEETING *Tuesday, Dec. 12, 9 a.m. EST* » The Federal Open Market Committee meets to set monetary policy. Economists queried by Action Economics unanimously expect the Fed will hold interest rates at 5.25%.

RETAIL SALES *Wednesday, Dec. 13, 8:30 a.m. EST* » November retail sales most likely rose 0.3%, after an October fall of 0.4%. Excluding autos, sales probably edged up 0.2%, after a 0.1% dip.

BUSINESS INVENTORIES *Wednesday, Dec. 13, 10 a.m. EST* » Inventory levels most likely grew 0.3% in October, following a 0.4% rise in September.

CONSUMER PRICE INDEX *Friday, Dec. 15, 8:30 a.m. EST* » In November, consumer prices likely rose 0.2%, after lower gasoline prices led the October index to fall 0.5%. Less energy and food, the index is forecast to have climbed 0.2%, after inching up 0.1%.

INDUSTRIAL PRODUCTION *Friday, Dec. 15, 9:15 a.m. EST* » November factory output probably improved 0.3%, after a 0.2% October gain. The utilization rate probably climbed back to 82.4%, from 82.2% in October.

The *BusinessWeek* produc slipped to 283.6 for the we Nov. 25, a 7.6% gain from a ago. Before calculation of week moving average, the declined to 283.7.

BusinessWeek

For the BW50, more inv data, and the componen production index visit www.businessweek.com/extra

ompany Index

index gives the starting page for a story or feature with a significant ence to a company. Most subsidiaries are indexed under their own es. Companies listed only in tables are not included.

ted Investors 146
(ADDDY) 52
staff (ASF) 38
(ADBE) 96
AET) 38
ystems (AGR)

3) 32, 36, 96
36, 58, 138
etworks 36
.com 54
lectronics 28
.com (AMZN)

MD) 36
n Girl (MAT) 82
APL) 46, 58
aniels
d (ADM) 58

eca (AZN) 110

m (BIDU)

Republic
48
lufsen 82
merica
6
ew York
120
oble (BKS) 96
dy Works 58
cience &
ogy 137
54
ns (BSC) 120

Berkshire Hathaway (BRK) 58
Best Buy (BBY) 46
Blackstone 56, 96
Bloomingdale's (FD) 126
BMW 28, 96
Boeing (BA) 36, 58, 124, 138
Boston Scientific (BSX) 58
BP (BP) 58, 132
Broadcom (BRCM) 38, 96
Burrill & Co. 42

C

Cablevision (CVC) 96
Cartier 82
Caterpillar (CAT) 96
Cazenove 58
Celunol 132
Ceres 132
Chevrolet (GM) 96
Chevron (CVX) 58
China Mobile (CHL) 58
Christian & Timbers 120
Chrysler (DCX) 36, 124
Circuit City (CC) 46
Cisco (CSCO) 56, 82, 148
Citigroup (C) 50
Citrix Systems (CTXS) 38
Coca-Cola (KO) 52, 58
College Sports Television (CBS) 48
Colony Capital 36
Comcast (CMCSA) 48
CompUSA 46
Comverse (CMVT) 96
Cowen (COWN) 42, 148
CVS (CVS) 110

D

Dell (DELL) 46, 58, 82, 148
Douwe Egberts 52
Duane Reade 22
Duke Energy (DUK) 96
DuPont (DD) 96, 132
Dyadic 132
Dyson 82

E

Eclipse Aviation 82
Electronic Arts (ERTS) 52
Eli Lilly (LLY) 110
ESPN (DIS) 48, 82

F

Flickr (YHOO) 14
Food Network (SSP) 58
Ford (F) 50, 58
Forrester (FORR) 46
Fox Sports 48

G

Gannett (GCI) 148
Gap (GPS) 58, 148
Gazprom 50
GE (GE) 58, 96
Genentech (DNA) 42
Geneva Lab 140
GM (GM) 14, 50, 56, 58
Goldman Sachs (GS) 96
Google (GOOG) 14, 54, 58, 96
Governance Metrics 46
Grameen Bank 96
Griffin Technology 140
Guess? (GES) 126

H

Hanover Compressor (HC) 96
Harrah's (HET) 36
Hearst 96
Heineken 50
Hewlett-Packard (HPQ) 46, 58, 96, 148
Hi-Tech Pharmaceutical 110
Honda (HMC) 14, 56, 82
Honeywell (HON) 137

I

IBM (IBM) 58, 96
iHome 140
IKEA 52
Independence 148
Intel (INTC) 36, 154
Interactive Data (IDC) 46
Interface (IFSIA) 96
Internet Crimes 110
Inter Parfums (IPAR) 148
iTouchless 82

J

J. & W. Seligman 148
J.C. Penney (JCP) 58
J. Crew (JCG) 58
JPMorgan Chase (JPM) 33, 44

K

KB Home (KBH) 56, 82
KKR Financial (KFN) 96
Kohl's (KSS) 58, 126
Korn/Ferry (KFY) 120
Kroger (KR) 110

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Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

L

Lands' End **58**
Leica **82**
Le Pain Quotidien **50**
Lexus (TM) **58**
Littler Mendelson **120**
Logitech (LOGI) **46**
LSI Logic (LSI) **36**
Lufthansa **36**
Luxoft **50**
LVMH (LVMUY) **48**

M

Marbridge **54**
Market Profile Theorems **38**
Marks & Spencer **50**
Marsh & McLennan (MMC) **58**
Martha Stewart Living (MSO) **56, 82**
Mascoma **132**
Mazda **82**
McAfee (MFE) **148**
McDonald's (MCD) **36**
Medco (MHS) **110**
Mercedes-Benz (DCX) **36**
Merck (MRK) **82**
Microsoft (MSFT) **46, 82, 96**
Mio Technology **82**
Mittal Steel (MT) **58**
Morgan Stanley (MS) **54, 120, 146, 154**
Mozilla **96**
MySpace (NWS) **14, 58**

N

NASDAQ (NDAQ) **58**
NCR (NCR) **14**
Netflix (NFLX) **38**
Network Appliance (NTAP) **38**
Neurocrine Biosciences (NBIX) **42**
New Chemic **110**
News Corp. (NWS) **58, 96**
New York Times (NYT) **32**
Nike (NKE) **50, 58, 82, 129**
Nintendo **82**
Nippon Steel **58**
Novartis (NVS) **110**
NPD Group **46**
Nucor (NUE) **58**

O

Omnicom (OMC) **52**
Openwave (OPWV) **38**
Optimus Solutions **120**
OSI Pharmaceuticals **42**

P

Panasonic (MC) **28, 82**
PepsiCo (PEP) **58**
Pfizer (PFE) **14, 36, 42, 56, 58, 110**
Philips **82**
Piper Jaffray (PJC) **148**
Planetpharmacy.bz **110**
Play Bac Presse **16**
Polk Audio **28**
Prudential (PRU) **96, 148**

Q

Qihoo.com **54**
QUALCOMM (QCOM) **36**

R

RadioShack (RSH) **28**
Raytheon (RTN) **96**
Reader's Digest (RDB) **58**
Red Hat (RHAT) **38**
Reebok **82**
Revlon (REV) **58**
RF Micro Devices (RFMD) **36**
RIA **110**
Rosneft **50**
Rydex **96**

S

Samsung **36, 82**
Sara Lee (SLE) **58**
Saturn (GM) **14**
S.C. Johnson & Son **58**
Seagate (STX) **36**
Secure Computing **110**
Sequoia Capital **54**
Sibneft **50**
Siemens (SI) **137**
Sina.com **54**
Singapore Airlines **138**
Sirius Satellite (SURI) **28**
Sohu.com **54**
Sony (SNE) **36, 46, 52, 56, 82**
Spalding **82**
Starbucks (SBUX) **16, 46**
Starwood Hotels & Resorts (HOT) **96**
Station Casinos (STN) **36**
Steve and Barry's **82**
StrawberryFrog **52**
Sun (SUNW) **56, 58**

T

Tamarack Energy **132**
Target (TGT) **82, 126**
Tesla Motors **82**
Texas Pacific **96**
Thomas & Betts (TNB) **38**
Thomson (TOC) **38**
3M (MMM) **58**
Tiffany (TIF) **44**
Toshiba (TOSE
Toyota (TM) **14, 58, 96, 124**

U

UnitedHealth **14, 58**

V

Vanguard **146**
Viacom (VIA)
Viktor & Rolf
Virgin **96**
Vonage (VG)
Vontobel **148**

W

Wal-Mart (WM **52, 58, 96,**
Walgreens (W
Wendy's (WE
Whole Foods
Wieden + Ke
WisdomTree(
World Wrest Entertainn (WWE) **16**
Wrigley (WV

X

Xerox (XRX)
XM Satellite

Y

Yahoo! (YH **54, 58**
YouTube **14**
Yukos **50**

Z

Zipcar **58**

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Best Business Books of 2006

Wal-Mart would be nowhere without the metal box. When experts look for the factors behind the recent vast increase in world trade, they tend to point to such things as new communications technology and the advance of Third World capitalism. But, says author Marc Levinson, there's another, often-overlooked cause: the shipping container. In the early 1960s, before the now-ubiquitous can was much employed, moving goods from one country to another was often prohibitively expensive. Today freight costs are all but negligible. In **The Box: How the Shipping Container Made the World Smaller and the World Economy Bigger** (Princeton University), Levinson delivers an engrossing account of how this came to be. Of particular note is his chronicle of Malcom P. McLean, a North Carolina truck driver who built a freight empire and then, 50 years ago, gambled everything to create the first company with containerized ships.

You say you would rather think out of the box? Well, Levinson's work is only one of the top 10 business books of the year as selected by *BusinessWeek* reviewers.

2006 produced a bumper crop of memoirs and biographies. A pioneer of capitalist creativity is described in **Hershey: Milton S. Hershey's Extraordinary Life of Wealth, Empire, and Utopian Dreams** by Michael D'Antonio (Simon & Schuster). This is a richly detailed look at the chocolate man and an absorbing history of his company. By the late 1890s, Hershey had figured out that the future lay not in caramels, which he first made, but in chocolate, which had already claimed a mass market in Europe. D'Antonio describes how Hershey perfected a distinctive version of the stuff and had sales approaching $8 million by 1913. The author also devotes considerable ink to the Pennsylvania town Hershey designed according to his utopian principles. By the early 1900s, the manicured burg featured electrified, centrally heated homes owned by well-paid company workers, a state-of-the-art chocolate factory, a medical clinic, and, as its centerpiece, a model school for orphan boys supported by a foundation that held the ma of company stock.

A much better known capitalist and philanthropist is the subject of David Nasaw's absorbing **Andrew Carnegie** (Penguin Press). By the time of his death, in 1919, Carne had bequeathed a total of $350 million, or at least $8 billion in today's dollars. "My business is to do as much good in the world as I can," he announced. But as Nasav shows, Carnegie's roles as philanthropist and rapacious businessman were closely linked. He pushed his partnei his employees relentlessly, so that he could give away ev more money. He did his best to monopolize steel produc fix prices, and restrict foreign steel with tariffs. He extoll leisure for all, yet he fought bitterly against steelworker attempts to cut their 12-hour days to 8 hours. The book

Power players, Wall Street workings, the Internet's impact

meticulous account of a paradoxical American origina

You can read about a mogul who turned his fortune different ends in **The Sack of Rome: How a Beautiful Europ Country with a Fabled History and a Storied Culture Was Tal Over by a Man Named Silvio Berlusconi** by veteran journa Alexander Stille (Penguin Press). As Prime Minister fr 2001 to 2006, Berlusconi owned or controlled all six o Italy's national television networks, or 90% of the cou airwaves. But here, Berlusconi comes across not as a t CEO but as an unscrupulous salesman who ruthlessly deploys cronyism for maximum financial gain, exploit power to attack rivals, and changes laws to derail crim lawsuits against himself. At the same time, readers co

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understand Berlusconi's showman-like appeal. Said reviewer Gail Edmondson: "*The Sack of Rome* is a frightening case study and one that has plenty of bearing on our own media-driven politics."

One other biography focuses on a living legend: Andrew S. Grove, the former Intel CEO. In **Andy Grove: The Life and Times of an American** (Portfolio), Harvard Business School historian Richard S. Tedlow takes a comprehensive look at the tech titan's life and work, providing greater entrée than ever before into Grove's mind. Tedlow tracks the passage of young András István Gróf from communist Hungary to the U.S., his schooling, and his early years at Intel Corp., where he became operations director under co-founders Robert Noyce and Gordon E. Moore. Later chapters describe the company's growth pains, various crises, and struggles to adapt to rapid technological change. The author draws on Grove's personal journals to show the evolution of his thinking—and to chronicle his doubt and satisfaction. One shortcoming: Grove's personal life remains relatively unexplored.

How can you crank up innovation? Why is failure almost inevitable?

Why are some companies able to crank out one breakthrough after another, while others search in vain for a single great idea? To Curtis R. Carlson of research and development contract firm SRI International, true innovation is less the result of individual eureka moments than of taking a methodical, disciplined approach. In **Innovation: The Five Disciplines for Creating What Customers Want** (Crown Business), Carlson and co-author William W. Wilmot say: "The best source of information...is your prospective customers and partners." Other recommendations include building innovation teams, brainstorming frequently with participants from different departments, empowering "champions" to keep initiatives on track, and aligning the entire enterprise around creating value for customers. Carlson knows whereof he speaks. His company, renowned since the 1970s, pioneered everything from the computer mouse to robotic surgery.

The most disruptive innovation faced by a majority of companies continues to be the Internet. And in the analysis of *Wired* Editor-in-Chief Chris Anderson, the far-reaching effects are still being absorbed. In **The Long Tail: Why the Future of Business Is Selling Less of More** (Hyperion), Anderson asserts that the mass market is giving way to "a mass of niches." As the Net relentlessly cuts the cost of finding and distributing products, it's accelerating the arrival of entirely new markets for obscure books, movies, games, foodstuffs, and more. Now, niche products can be stocked efficiently in warehouses, ordered by anyone with a computer and a credit card, and shipped cheaply around in the world. Does that spell the end of the Hollywood blockbuster? Some of Anderson's clair exaggerated, but *The Long Tail* is one of this season's mo thought-provoking books.

Also stimulating is **The Poker Face of Wall Street** (Wiley which reviewer Peter Coy called "a sprawling, idiosyncr and sometimes poker-obsessed book filled with nug about American history and finance." Auth Aaron Brown, a respected Morgan Stanley risk manager with degrees from Harvard University and th University of Chicago, offers a novel thesis: Gambling has be a basic engine of U.S. capital For example, he says, bettir became a key means of cap formation on the Western frontier, providing winner with stakes big enough to fund major projects. The s wagering instinct, says Br lay behind the creation of t agricultural futures exchan The book's arguments, such a perceived mathematical lin between bookmaking on the W Series and the pricing of stock op aren't always easy to follow. But it's quirkiness that makes this work speci

Another surprising volume is **Why Mo Things Fail: Evolution, Extinction & Economics** (Pantheon) by economist Paul Ormerod. Failure, says the author, is endemic: The is simply too complex for anyone to make predictions about anything but the near f What you can't predict, you can't avoid. A consequence, mass extinction—whether species or businesses—is more common we might imagine. What can be done? O provides a few suggestions. For governm counsels restraint, since most interventic market workings will just make matters For business, he offers two bits of advice. trying to predict the future, because "eve bit of genuine knowledge goes a very long way." And experimenting, because eventually something will par

Finally, a fun read that draws insights from a wide ra of scholarly disciplines is Michael J. Mauboussin's **More You Know: Finding Financial Wisdom in Unconventional Place** (Columbia University). The intellectually omnivorous a chief investment strategist at Legg Mason Capital Man and an adjunct professor at Columbia Business School. 30 brief chapters, he tackles investment philosophy, the psychology of investing, competitive strategy, and comp theory. Abstract concepts, from the difference between and uncertainty to the distinction between individual a collective decisions, are described with the help of a div set of characters, from gambling legend Puggy Pearson golfer Tiger Woods. "You will be a better investor, exec parent, friend—person—if you approach problems fror multidisciplinary perspective," he writes. With prospec that, you'll be more than ready to face the New Year. ■

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WITH **MARIA BARTIROMO**

A Death in London

THE RUSSIAN CHESS GRANDMASTER Garry Kasparov always has the next move in his head. But he is as perplexed as anyone by what the next move will be in the cloak-and-dagger drama surrounding the killing in London of former KGB member Alexander Litvinenko. Kasparov is now chairman of the United Civil Front, an organization of disparate political groups that seeks to rebuild Russia's fledgling democracy. He suspects that Litvinenko got caught in a Kremlin power struggle over what will happen in 2008 when President Vladimir Putin is scheduled to step aside.

KASPAROV

What is the mood like in Moscow?
There are many people who are very happy with the current situation, but many more who are unhappy. The farther outside Moscow you go, the more that unhappy number increases. [Some] 85% of the people are not receiving real benefits from the [energy wealth], but 15% are quite happy because they are related to the bureaucratic groups running things....The picture is not as rosy as presented in *The Financial Times* and *The Economist*. Just look at the statistics: While the center of Moscow is arguably the most expensive place in the world, some would say more expensive than New York, the average income per capita is $1,000.

What's behind this inequality?
The system is not based on the rule of law and a properly functioning economy. ...Obviously, the financial situation of many Russians during Putin's reign has improved...[but] the peak of the improvement was in 2004-05. Now people are no longer seeing benefits in the way they expected. If Putin goes in 2008, the whole system will be shaken. Many groups will fight to succeed him. If he stays, under pressure from groups that would like him to stay no matter what, then the system will change. He will lose his legitimate status, not only in Russia but in the world. Of course, for the Russian elite, Putin's rigid status is the main guarantee of their fortunes... this is not money made out of normal business practices.

Are people talking about the Litvinenko killing?
It is not just Litvinenko. Anna Politkovskaya was murde Oct. 7. She was a journalist and one of Putin's harshest She was saying that Putin and his gangsters should be b to justice. Most likely [these two killings] are related power struggle for Putin's position.

This has caught the attention of the world.
Yes, because...the use of polonium [the radioactive sub that poisoned Litvinenko] is another alarm for the We terrorists don't need a dirty bomb. They just need a few of such elements dissolved in a water system. I don't what kind of message those who killed Litvinenko wa send, but...for whatever reason, they to demonstrate that there are Russian on [this murder]...because poloniu only be produced in certain places.

Do you think Putin is behind these killi
No. It is highly unlikely that Putin hi behind the killings. But there are tho would like Putin to stay in power an all his bridges.... And there are tho would like him to...appoint a successo groups want him to be compromised better positions for the final struggle.

Doing business there must be frighter
Some people are making tons of because they established good re with Russian officials. But if you wa conventional business, you shouldn Russia. Political events can jeopard project, even if it is signed and re major [business] activities in Rus pend on the approval of a certain g government. [And a new law] bans criticism of the go body. Can you imagine an election when you are not to criticize your opponent? If you want change in you can't discuss it. And if you discuss it, you are co an extremist. [Our organization] is trying to form sensus from right to left that agrees on the princip functioning, free state: restoring elections, guara freedom of speech, and making sure the country is those who are properly elected. We are all afraid and be cautious. I am not feeling like a hero, but there is choice for us. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell.

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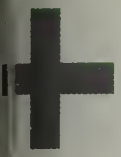

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IdeasTheWelchWay

BY JACK AND SUZY WELCH

Getting Back on the Radar

I have been working at the same company for the past five years, and recently I've noticed that new MBAs are passing me by and moving into management, which I assume is because they're cheaper for the company. Do you see this as a trend in the corporate world?

–Anonymous, Kenosha, Wis.

No! Most companies don't promote greenhorns just to save a few thousand bucks here and there; they promote people who exude the kind of positive energy, ambition, and intelligence that can propel an organization forward. So understand—the upward MBA escalator in your company is probably not about corporate economics. What you're seeing is most likely a downward trend in your career. Without doubt, you've hit some kind of wall, and if you don't find out why soon and repair the damage, it won't be long before you're passing those "bargain-basement" MBAs on your way out the door.

Unfortunately, it could be difficult to get the answers you need. Clearly, your managers haven't been candid with you about your performance to this point. Perhaps they expected you to read the writing on the wall and draw your own dire conclusions. Appraisal avoidance shouldn't happen, but it often does when the news is going to be bad.

> With their silence, your bosses are telling you something—and it's not good

Your job then is to gently initiate some kind of conversation with the boss you're closest to, even if it is just to obtain a vague sense of what's going on. But just as important, you need to start pouring energy into getting back on the radar screen.

The most effective way to do that, not surprisingly, is to over-deliver. Whatever you're doing, do it better and faster. Expand your job's horizons to include bold new activities. Come up with a new concept or process that doesn't just improve your results, but your unit's results and the company's overall performance. Surprise everyone.

A second powerful comeback technique is to raise your hand when the call goes out for people to sign up for major projects and initiatives, especially ones that don't have a whole lot of popularity at the outset. Volunteer to work in a branch office in a tough competitive market or jump at the opportunity to be part of a big, new quality drive. A global assignment right now may take you too much out of the picture for your immediate purposes, but it is directionally correct. You need to prove you're willing and able to go the extra mil

Finally, if you are draining away political capital with organization in any form, stem the flow immediately. Tl means you may need to stop disparaging fellow employ even in jest, or acting in any form like a wet blanket. Ri now, your attitude needs to shout one word: "Yes."

Can we guarantee that these three "fixes" will revive career? Of course not. The facts are, sometimes a perso been underperforming for so long that they get an emb reputation. No matter how hard you try, you will alway seen as the same old you.

If, after a period of trying, you get the feeling that's t your case, we suggest you jump before you're pushed. I a company with a better fit, doing work you like. Then wait for the silent treatment to alert you: From Day On building the results and reputation that will make you t new kid rising through the ranks.

Doesn't differentiation—the system of paying top perform much more than everyone else and moving out the weak performers every year—destroy employee loyalty?

–Andre Rapoport, São Paulo

Look, loyalty is no magic bullet. In today's globally comp world, you can't survive, let alone thrive, without satisfie customers. Do "loyal employees" make that happen? Su sometimes. But for satisfied customers all the time, you employees loaded with talent, energy, and passion. You people who aren't with your company because you take everyone all alike and the dental benefits are good, but b your mission turns them on, the work is fun and meani and the opportunities for growth are thrilling. You need who are happy to stay but ready to leave if the environm isn't buzzing. Those are your winners.

We're not against employee loyalty, of course. It's sure than hostility or apathy! But the concept of employee loy a corporate and societal virtue went out the door with life employment, which had to go when foreign competition Differentiation was the antidote.

It has its flaws but works better than any other system know. One reason: It makes clear that employees can onl as long as they're performing. If that causes some people disloyal, let them go. You need employees sticking aroun more than security—namely, opportunity and growth. ■

Jack and Suzy Welch look forward to answering your questi about business, company, or career challenges. Please e-mai them at **thewelchway@businessweek.com.** *For their we podcast, go to www.businessweek.com/search/podcasting.ht*

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akers will be as busy as ever

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cial sector offerings paid off big, ch stocks are back

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ing in the environment may be ewarding with the new Congress

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band can help you climb aboard

d Europe, Worth a New Look
ntinent's growth is turning heads

erging Markets Have Emerged
ets are becoming smart plays

azil's Keyed-Up Consumers
ing middle class heats up stocks

apanese Rebound?
e "buy Japan" camp is staying put

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Investment Outlook

51 Where the Buys Are Yes, you can complain about a tepid housing market, upwardly mobile energy prices, and an anemic dollar. But smart planning should still deliver a rewarding year. Our team of economists, pundits, and financial advisers will help you suss out the best deals on international stocks, income investments, and much more

CONTENTS

46 | CRAMER

34 | TAKEOVERS

Smart Strategies

90 Hitting the Income Trail
Money-market funds offer satisfying yields and safety, but corporate dividends are increasingly appealing

94 Expert Advice for Real-Life Finances
Four investors, at different stages of life, get advice from expert financial planners

102 Escaping the Dollar Doldrums
ETFs and other instruments make currency investing as easy as stocks

104 Large Caps' Turn to Shine
Forecasts of a slower-growing economy have money managers thinking big

110 When to Dump a Stock
Many investors tend to hang on too long. How to tell if it's time

114 Housing: The Downturn Isn't Over
It could be 15 years before prices return to their inflation-adjusted highs

116 Art's New Frame of Reference
India, China, Russia.... As collecting goes global, prices have room to run

Mining the Numbers

118 Diving into the Data
Before buying a stock, you should check a lot more than just the numbers

122 Outlook Scoreboard 2006

The Business Week

32 News You Need to Know
A sky full of mergers; the Fed sits tight; Paulson in China; Sakhalin 2; and more

News & Insights

34 Deals: It's Getting Ugly Again
Low interest rates, ample cash, and trillions in private equity add up to a tidal wave of hostile takeovers

37 'Foreclosure Factories' on a Roll
How some mortgage servicers use aggressive tactics to rake in fees

39 Hyundai: Too Far, Too Fast?
Korea's strong currency is battering the carmaker's competitive edge

40 Goodbye Freebies, Hello Freedom
Cell-phone customers who are willing to pay more can switch carriers at will

42 Selling Breast Implants, Quietly
Allergan is taking a low-key approach

46 Cramer on Cramer
Editor-in-Chief Steve Adler talks with the *Mad Money* man

Economics

29 Business Outlook
Jim Cooper says consumer spending will be able to offset the housing slump

Columnists

24 Steve Wildstrom: Tech & You
Next year's big story is software

26 Jon Fine: Media Centric
The new sport of billionaires: Buying newspapers

148 Robert Parker: On Wine
'Tis the season to be bubbly

162 Maria Bartiromo: Face Time
Hank Paulson on China and 2007

164 Jack and Suzy Welch: The Welch
Too many boards are running so sca that their real work isn't getting don

Personal Finance

150 Inside Wall Street
Gene Marcial's stocks to watch

152 Figures of the Week

Ideas

158 Books
Davis, Lukomnik, and Pitt-Watson: *The New Capitalists*

Features

13 UpFront
22 Readers Report
154 Index to Companies

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Prague is becoming a hot locale f outsourcin

New Offshore Frontiers

In the global hunt for low-cost labor, companies are starting to look beyond Bangalore, India's high-tech outsourcing hub. BusinessWeek.com's CEO Guide to Technology features **emerging cities for outsourcing** where plenty of high-tech talent can be found at rock-bottom prices—but not without a new se of challenges. In a slide show, we highlight **10 up-and-coming locales** that will help you discover which is best at building security systems (Bucharest) or where to find the top **open sou developers** (Buenos Aires). If you're looking for the next low-price location, consider our **Tip Sheet** before sending your worl halfway around the world. Or to find out why one of the large offshore service providers has moved into Bucharest and Dali China, catch our **Video View** with Genpact CEO Pramod Bhasin Also, see how Vietnam is emerging as an outsourcing destina with Microsoft, Electronic Arts, and Sony sending video game development work to Ho Chi Minh City. Finally, listen to a **poc** with Atul Vashistha, co-author of *The Offshore Nation,* as he ta about the pros and cons of various cities. For all this and more to **www.businessweek.com/technology/ceo_guide.**

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UP Front

"Anyone at the bonus line at Goldman Sachs died and went to bonus heaven."

–Michael Holland, chairman of investment firm Holland & Co., on the $16.5 billion (equal to $623,418 per employee) Goldman Sachs will award in total compensation this year, as reported by The New York Times

D BY DEBORAH STEAD

WIND

RIS' RFUMER IS T SO HOT

LITE Paris Hilton has hot property for Fragrances, the Fort rdale company that has d licenses ke perfume, ags, and items ng her name. artnership l push sales Parlux rly 30% a the three ended last , and landed mpany at No. 63 on *ssWeek*'s Hot Growth g of small companies. v swiftly an up-and- can stumble. On Dec. 6, announced it would e of its other top brands, llis, back to Ellis.

HILTON

Sales of Ellis perfumes had accounted for 31% of Parlux's $40.8 million in revenues in the most recently reported quarter, and the stock plunged 15%, to 5.77, on the news. Ellis was "one of their better brands," gripes Ivan Feinseth, an analyst for **Matrix USA.** "This is bad management."

Parlux has also been late with some SEC filings, leading to several NASDAQ delisting threats. The stock has dropped 47% in six months, and a major shareholder, Glenn Nussdorf, has announced he wants to acquire Parlux and make changes "at both the board and management levels." Nussdorf, Parlux CEO Ilia Lekach, and COO Frank Buttacavoli did not respond to interview requests. At least they'll always have Paris.

–Arlene Weintraub

THE BIG PICTURE

TO PARTY or not to party this holiday season? Most employees in a recent survey say they don't consider a company bash to be "important."

PERCENTAGE OF EMPLOYEES WHO:	
Feel holiday party is important	19%
Feel obligated to attend party	27%
Say they've embarrassed themselves	6%

mber, 2006, Spherion Workplace Snapshot survey of 1,639 employed adults. by Harris Interactive

TRUMAN & CO. His Special Committee saved billions

PROFITEERING PROBE

Give-'Em-Hell Nancy?

SOME REPUBLICANS complain that it's payback: The House's new Democratic majority, led by incoming Speaker Nancy Pelosi (D-Calif.), is planning to create a "Truman-like" committee next year to probe war profiteering, modeled on the panel President Harry S Truman created as a senator to investigate contracting waste and fraud in World War II.

Kevin Madden, spokesman for outgoing House Majority Leader John Boehner (R-Ohio), deems it "revenge" and "government by investigation." Democrats—including Representative John Tierney (D-Mass.), who came up with the idea—deny that. "It's part of our responsibility," Tierney says.

PELOSI

Senate Democrats are considering setting up their own version of the panel. And Pelosi is also endorsing plans to renew an investigative panel on the House Armed Services Committee that was dissolved in the 1994 Republican sweep in Congress. "The corruption in contracting in Iraq is staggering," she says. The Dems will focus their subpoena powers on Iraq contractors, as well as on Defense and White House contracting officials. Truman's Special Committee to Investigate the National Defense Program held 432 hearings, issued 51 reports from 1941 to 1948, and saved taxpayers some $15 billion.

–Dawn Kopecki

UPFront

HOT ROCKS

THE LATEST MUST-HAVE: DESIGNER ICE

As anyone who enjoys spirits can attest, ice cubes can melt into bad-tasting water, compromising that pricey single-malt Scotch.

Enter specialty ice. Aquaice, based in Dublin, Ohio, sells purified water in sealed trays to restaurants (and some retailers) and recently got private equity funding to go national with its $5 packets of 50 cubes. Then there are Icerocks, "spring water ice cubes," sold unfrozen and hermetically sealed by Miami-based Water Bank of America: $3.99 for 48 cubes.

Analysts say upscale ice cubes should remain a healthy niche business. "You can make purified ice at home just like you can make coffee at home, but we are a culture of $4 cups of coffee," says marketing consultant Dennis Keene.

Some bartenders are getting as picky about ice as chefs are about beef stock. At New York's Alain Ducasse at the Essex House, a Hennessy Cognac on the rocks (if you must have ice) comes with a purified ice "globe" from a mold provided by the spirits maker.

–David Kiley

SOUNDTRACKS

ANOTHER BUSY DAY AT THE HOME OFFICE

IF YOU'VE EVER had a conference call interrupted by a doorbell, barking dog, or wailing baby while working at home, you know that some sounds aren't conducive to doing business.

Cue *Thriving Office*, a CD that aims to give home businesses instant credibility by masking background noises with those of a bustling office.

Bill Freund, a San Francisco marketing executive, came up with the idea several years ago after feeling self-conscious about making sales calls from home. He recorded the sounds of people murmuring, walking, typing, answering phones, even shutting file drawers, then arranged them "like a symphony," using digital editing software.

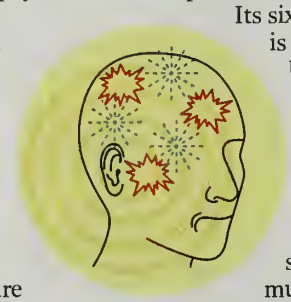
The result: two 37-minute tracks—the basic *Busy* and the amped-up *Very Busy*—that create the audio illusion of a dynamic office. "Controlled chaos," Freund calls it. Since September, when the product was first offered online at www.thrivingoffice.com for $12.95 ($5.95 for a short downloadable version), sales have been "positive" says Freund, who guesses that most buyers are entrepreneurs or remote workers. And he adds that customers say the sound has turned out to have an unforeseen benefit—the hum seems to boost their productivity at home when they're off the phone.

–Elizabeth W

NOW HEAR THIS

TUNING INTO A TREATMENT FOR RINGING EARS

TINNITUS, a chronic ringing, whooshing, or buzzing in the ears, affects up to 50 million Americans, says the **American Tinnitus Assn.**, including 49% of U.S. soldiers returning from Iraq and Afghanistan. (In 2005, disability payments to veterans with tinnitus reached $418 million, says association CEO David Fagerlie.)



Some 12 million Americans with the condition—linked to exposure to loud noises and certain drugs, hearing loss, and aging—seek treatment. But most get little or no relief from existing herbal or masking therapies.

Now an Australian health-care company, **Neuromonics**, has come up with a treatment that seems to be getting good results using an MP3-like device. With $12 million in venture capital, the company, founded in 2001 by a clinical audiologist, now has a U.S. operation in Bethlehem, Pa.

Its six-month treatment is being used in 33 U.S. clinics, with plans to expand to 165.

The Neuromonics device uses a patient-specific mix of music and high-frequency white noise to ease symptoms. Later, it habituates sufferers to their tinnitus. The idea is to train the brain to block the noise even when the device isn't being worn. The treatment (device and audiologist time) costs about $5,000. Neuromonics says more half of 700 patients who had the therapy report r months after completing treatment. *Ear and Hear* the American Auditory Society journal, will pub an article next year on th company's clinical trials.

At Ohio's Cleveland C Dr. Craig Newman has u the system with 25 patie Though "it's still very ne he says, "it seems to hav worked better than exist treatments." The device, says Ian Bund, a partner at **Innovation Capital**, one Neuromonics' investors, has "the ingredients tha make venture capitalists excited," among them, a market and "a great dea interest from practitione

–Aili McCo

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BUCKLE UP

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GIFT SHOPPING

THE FRENCH ARE GETTING PERSONAL

STARTING in mid-December, Paris' two main airports are offering a service they say is unique for major hubs: 20 personal shoppers who help harried travelers buy holiday gifts at the 200-plus shops at Roissy (known as Charles de Gaulle) and Orly airports.

Stationed at kiosks in bright pink-and-black outfits, the young women offer their aid free of charge in more than a half-dozen languages. And thanks to a study previously conducted by the airports' managing group, **Aéroports de Paris**, they're also versed in national gift-buying habits. (Japanese men go for luxury watches, many African men buy perfume, and Yanks and Brits favor items that say "Made in France.")

Aéroports de Paris hopes the personal approach will encourage some of the 3.5 million travelers expected from Dec. 15 to 29 to open their wallets even wider than usual. In 2005, the group's 25% share of sales at its airport shops, including luxury goods purveyors **Cartier** and **Hermès**, came to $339 million. If the experiment is a success, a spokesman says, the personal shoppers may become a seasonal fixture.

–Dan Carlin

BLOGSPOTTING

From "How to Explain What You Do for a Living," posted Dec. 11 on Bankersball.com, a blog for investment bankers and financiers:

It's the time of year you have to repeat who you are and what you do about a billion times.... Which is why we've come up with a handy 20-seconds or less response tailored to each person you might encounter over the holidays...

» Parents: "I have a job."

» Uncle Marty: "Buy Google."

» Younger brother: "Whatever you do, don't do what I'm doing. People will tell you it's awesome but it's not."

» Person at party you want to get rid of: "You ever see *American Psycho*?"

» Hipster/trustafarian: "I work at JPMorgan—just like your Dad."

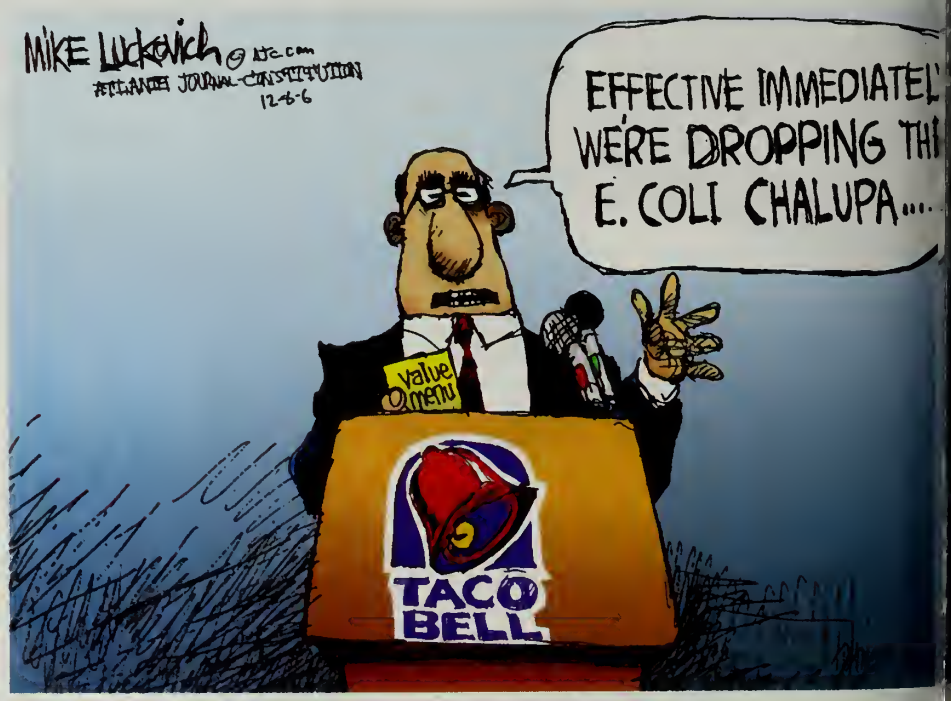
» Girl at bar: "...I quit to start my own line of T-shirts. We just got picked up by Barneys so it's really a breakthrough year for us..."

» Another banker: [secret handshake]

TRENDS

MY, MY, MY

»IN THE SPACE of a few weeks, recently: Fidelity Investments introduced MyPlan, an online retirement savings tool that gives users asset allocation advice. Wells Fargo rolled out its My Savings Plan, a Web service that gives users a consolidated view of their spending. And American Century unveiled the "My [Whatever] Plan," a Web-based line of investment products. Why is cyberspace becoming myberspace? "My" has become shorthand for today's interactive Web, says Martyn Tipping, president of brand management firm TippingSprung. "'My' is the next 'i,' which was the next 'e,' which was the next 'cyber,'" he says. *–Lauren Young*



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TONY PIETROMICA'S STORY

"Finding a wonderful opportunity like Arteriocyte in Ohio was beyond our expectations."

Tony Pietromica
Director of Operations
Arteriocyte, Inc.

After years of living on the East Coast, returning to Ohio for his MBA became an experiment for Tony Pietromica and his family. Fully prepared to move back East, they were pleasantly surprised to find both their career satisfaction and quality of life improved in the Buckeye state.

With his extensive experience in bioinformatics, Tony seized an exciting opportunity with Arteriocyte Inc., a newly formed Cleveland biotech company. Arteriocyte is developing adult stem cell therapies to treat ischemia in patients suffering from a variety of circulatory ailments. Ohio's outstanding community of universities and research institutions provides an ideal location. And the company has found that doing business in Ohio is much more cost effective than on the coast, speeding up its growth. In fact, Arteriocyte was able to enter its first clinical trial early this year.

The Pietromicas quickly discovered that East Coast stereotypes of Ohio were without merit. They were able to cut their living expenses in half while increasing the space and amenities of their home. Restaurants, activities and entertainment choices have exceeded expectations. And the relaxed pace and easy commute give them more time to spend with good friends and family and enjoy their hobbies. There's no going back. The Pietromicas are proud Ohioans once again.

To see why, come visit OhioMeansBusiness.com. Or call 1-877-466-4551.

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BY THE NUMBERS

IS CHINA REALLY NO. 2 IN R&D?

ON DEC. 4, the Organization for Economic Cooperation & Development released a bombshell: In 2006, for the first time, China outspent Japan on research and development, forking out $136 billion, the agency calculated, against Japan's $130 billion and ranking second only to the U.S. (with $330 billion in R&D expenditures).

That figure came as a shock—not least to many in China. "You do have a general improvement in the quality standard across the board in research institutions," says entrepreneur Anne Stevenson-Yang, a former managing director of the U.S. Information Technology Office, an industry lobbying group in Beijing. But as a percentage of GDP "China's R&D spending is still quite low." That percentage: about 1.3%, or $33 billion, vs. Japan's 3.17%.

So how did the OECD arrive at its $136 billion figure? By adjusting for purchasing power parity. Because labor and other R&D costs are so much lower in China, researchers in the People's Republic were calculated to have gotten four times more for their R&D expenditures than their counterparts across the Sea of Japan. Some Chinese scientists point out, however, that the purchasing power theory doesn't reflect reality in the lab. The Shanghai Center for Antibodies, for instance, spends more than a third of the $10 million it receives annually from the government on expensive equipment, most of it imported from the West and Japan, according to Dr. Guo Yajun, the center's director. And those payments have to be in hard currency, not China's yuan (which still isn't freely convertible). It's "a lot," Guo says.

The OECD stands by its figure, but acknowledges that business claims the bulk of China's R&D spending.

RESEARCH A Chinese lab technician at work

Most of it goes to "short-term projects, closer to the market," instead of to basic research, says OECD senior economist Mario Cervantes. He says that it is also true that a disproportionately large share of R&D spending in China is for equipment and infrastructure, including expensive imported items, so that in the short term it may appear that Chinese labs are getting less bang for their research buck.

He adds that starting [illegible] scratch this way gives th[illegible] Chinese an advantage. "[illegible] can build a new system [illegible] and avoid the ivory towe[illegible] problem" of more-develo[illegible] countries, where academ[illegible] research is often far rem[illegible] from the needs of busine[illegible] he notes. "China is not y[illegible] an innovation powerhou[illegible] Cervantes says, "but the[illegible] potential for that."

–Bruce Einhor[illegible]
Carol M[illegible]

QUESTION OF THE WEEK

The Wal-Mart ad account is up for grabs again. What would be your pitch to the company for a new campaign?

"My advice: Focus on what's important to your customer, not just the next ad trend. Price has been the magic button, but do the research–find out what else resonates with Wal-Mart shoppers."

Robyn Waters, president, RW Trend; author, The Hummer and The Mini

"I'd tell them that their poor public image matters and that becoming a better employer, a model corporate citizen, is what people truly value. Once they do this, the ad pitch is easy: 'Wal-Mart: We've Changed for the Better'."

Chris Kofinis, communications director, WakeUp Walmart.com, an anti-Walmart group

"Wal-Mart has made it very, very big by recognizing that it must [illegible] create the impression an[illegible] the reality that it is the retailer with the lowest [illegible] price. It must stick to its [illegible] guns. It still has to beat [illegible] the low-price drum."

Kurt Barnard, president, Barnard's Retail Consulting Gr[illegible]

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"As a longtime user of Microsoft products, I believe using innovative and Microsoft in the same sentence is an oxymoron."

–Ken Leebow
Marietta, Ga.

A CHORUS OF RASPBERRIES FOR THE 'NEW' MICROSOFT

I KNEW THERE was something amiss in "The soul of a new Microsoft" (Cover Story, Dec. 4) when I read that J Allard was the visionary behind the Zune. The Zune is a poor attempt to copy a wildly successful product and is four years too late. Does that make Allard a visionary?

The fact that Allard, 37, posed as an 18-year-old at a video arcade is symptomatic of Microsoft Corp.'s core problem: It is desperately trying to be something it is not. Zune, Xbox, Internet Explorer, and Windows Media Player are all second-grade products, a result of Microsoft's trying to chase the real visionary companies such as Apple, Sony, and Netscape.

Microsoft is filled with smarts. Its stockholders might rather see the company invest this amazing brainpower in competing with the likes of Oracle, IBM, SAP, and Symantec. Leave Apple and Sony alone, and let them make the world a happier place.

–Shailesh Kulkarni
Chicago

AS A LONGTIME user of Microsoft products, I believe that using innovative and Microsoft in the same senten an oxymoron. For example, Micr recently introduced a new browse took five years to come out, and most notable feature is tabbed br ing, which has been available in Fi browsers for years. I have yet to read positive review of the Zune. Last bu least, the company's soon-to-be-rele behemoth operating system is bein livered more than a year late. Whil sure it will have many good features real innovators are moving their app tions online.

–Ken Le
Marietta

AFTER SEEING the success of the tendo 64 and Sony PlayStation, J A persuaded his deep-pocketed emp to build a game console, too. Surro ing himself with nine iPods and an A G5 computer, Allard persuaded his to build a similar product and se and call it Zune, not to be confused iTunes. This thinking is about as "e and "innovative" as pushing the bu on a copier machine.

–Nell W
New

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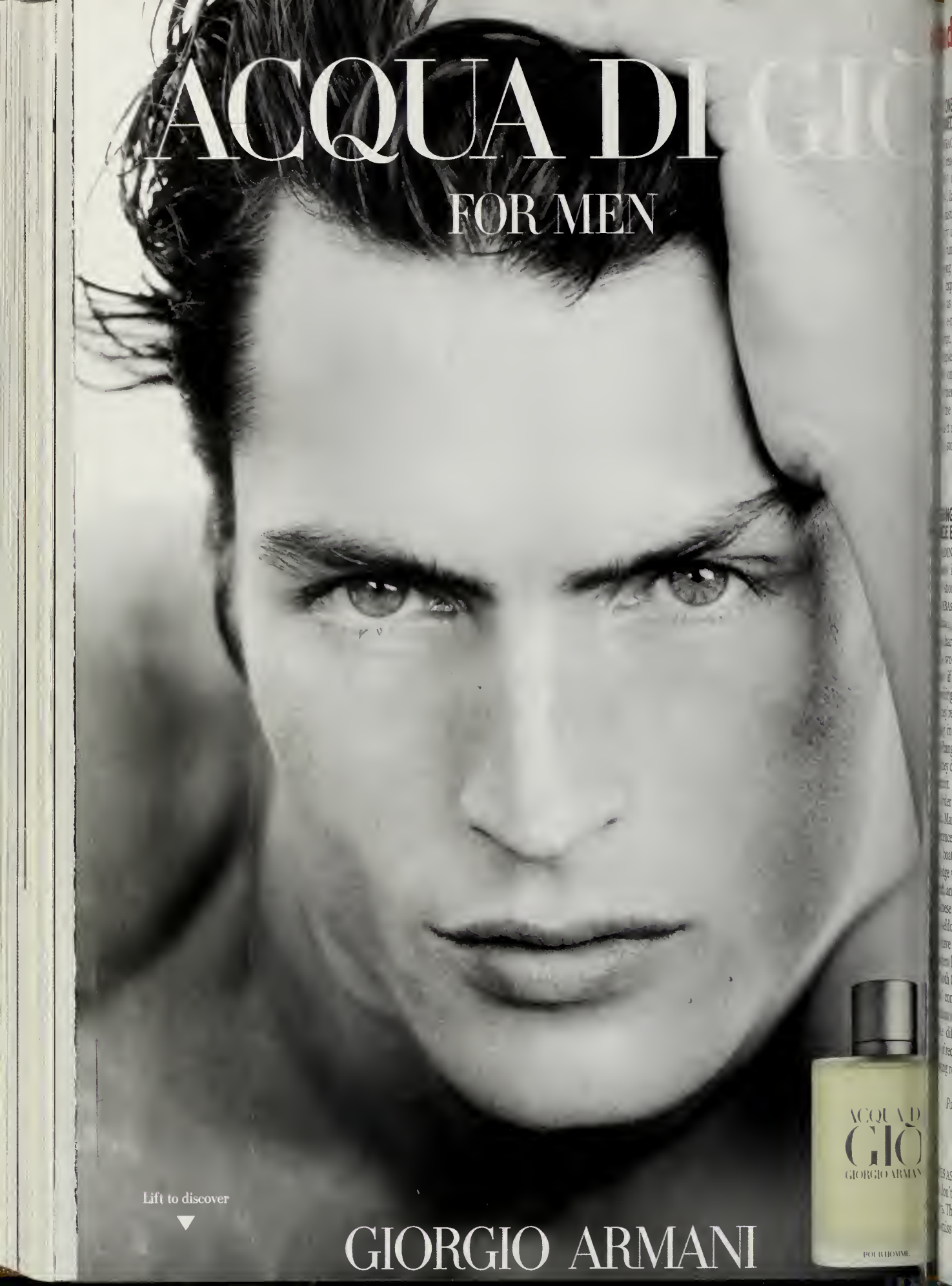
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POUR HOMME

ONE DOCTOR HAS RNED TO AVOID DUANE READE

S PRACTICING physician in New York it I read with interest "Duane Reade: BO on the critical list" (Finance, e 4). In addition to the myriad busi- mistakes described in the article, ery important error was missed: a y run pharmacy department.

ıong the big chains, it is my prac- experience that Duane Reade s us the most hassle, whether we e, e-mail, or electronically transfer cript. Patients tell me of long lines unpleasant service. I am probably he only doctor who raises an eye- when asked to call Duane Reade. e the pharmacy business is not as as it used to be, it does drive people he store to buy soda.

–Ira Daniel Breite, MD
New York

SHING PERSPECTIVES ON ESE B-SCHOOLS

ORDING TO COMMENTS made by iters in "China MBAs: Most likely l short" (B-schools, Dec. 4), Chi- MBAs are weak in the following: dence, self-expression, risk-taking, g charge, and decision-making.

is would be a strong indictment ps if these folks were going to orking in John Wayne's America. they're not. They're going to be ing in places like Beijing, Guang- Shanghai, and Tianjin, where other they do possess may be even more rtant.

order to manage a Chinese op- n, Mandarin-language skills, social etence, consensus-building skills, a boatload of local and cultural ledge will be crucial. The Harvard, ord, and Wharton MBAs with whom hinese MBAs were compared in the e seldom have these traits. And it d have been most interesting if the rchers had not pooled the responses "both Chinese and [foreign] multi- nal companies with operations on ainland." I'd bet a dim sum lunch the differences across those two s of recruiters would have made for sting reading.

–Professor John L. Graham
Paul Merage School of Business
University of California
Irvine

MES AS no surprise that Chinese B- ls don't pass muster with corporate iters. Their reliance on rote learning ubmission to authority also characterizes Chinese K-12 education. This kind of pedagogy ranks Chinese students ahead of their American counterparts on international tests, but the results call into question the validity of the negative inferences made about U.S. schools.

–Walt Gardner
Los Angeles

SIX SIGMA 'WORKS' BY ELIMINATING CUSTOMER SERVICE

AS A SMALL-BUSINESS owner, I have personally dealt with several manufacturers that have instituted the Six Sigma system ("Six Sigma still pays off at Motorola," The Corporation, Dec. 4). It may be good for manufacturers, but as a distributor of their goods, it was bad for me.

At each company, customer service declined, becoming less responsive and more rigid and unfriendly. Return policies became very restrictive. Customer service and field sales personnel were cut, and their duties were pushed onto distributors with no margin increase to compensate for the increased overhead. Their attitude became: "I will increase my bottom-line profit, and I am not concerned about the effect it has on you." Six Sigma is entirely one-sided, and there is no spirit of cooperation.

–Claude E. Beeler Jr.
Oklahoma City

FORGETTING WHAT MATTERS AT US AIRWAYS AND DELTA

AS ONE OF US AIRWAYS' most frequent customers, I found the quote from [Delta Air Lines Chief Operating Officer] Jim Whitehurst ("We are in bankruptcy because we have been losing in the marketplace") to be both historically accurate for Delta and predictively accurate for US Airways Group ("Flight plan," Managing, Dec. 4). I hope investors and the general public learn what customers are finding out about US Airways: It is falsely masquerading as a low-fare carrier, with disintegrating levels of customer service and flying value.

Doug Parker's model of what an airline should be is diametrically opposed to what customers require and well below what nearly all other American carriers are willing to offer. US Airways is removing first-class seats, increasing capacity controls and blackout dates on a dramatic scale, and raising fares unjustifiably.

Parker and his team will be unable to succeed without a Delta acquisition because fewer and fewer passengers are willing to follow them.

–Brian F. Gagan
Scottsdale, Ariz.

AS A VETERAN PILOT with 27 years at Delta, I'd like to add a few things to your article. The present management team has basically no airline experience. These people are Wall Street bottom line MBAs. So Delta looked at the only group of employees with no representation or influence on operations: retired pilots.

My monthly check from Delta went from $5,100 a month to zero. This is how Delta treats the people who flew their passengers safely for, on average, 30 years. The most professional and dedicated group of employees has been eradicated from the payroll, but the MBAs think it looks great on their résumés. At some point a CEO or bankruptcy judge should do what's morally right even if it doesn't look good on the bottom line.

–Ben M. Camp Jr.
Harper, Tex.

FREE CONFERENCE CALLS BEAT E-MAIL BY A MILE

AS PRESIDENT OF an online women's organization, I have been extremely dependent on e-mail for communication ("*!#?@ the e-mail. Can we talk?," Workplace, Dec. 4). However, I sensed something lacking in each exchange. Our biggest challenge was that our staff is global. An employee in Kentucky needed a way to communicate with a staff member in Paris.

Our solution came through Skype Technologies and free conference calling. Now members of the staff speak with one another at least once a week. We can effectively accomplish twice the amount of work, and I am able to leave my BlackBerry in my handbag .

–Ja-Naé Duane
President and Founder
Wild Women Entrepreneurs
Medford, Mass.

How to reach *BusinessWeek*

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Tech&You

BY STEPHEN H. WILDSTROM

Why the Big Story Is Software

I don't need to be much of a fortune teller to predict the key tech news of early 2007. Microsoft's two big efforts of the past few years, the long-overdue Windows Vista operating system and Office 2007, go on sale on Jan. 30. And Apple will follow a couple of months later with the Leopard version of its OS X software for Macs.

These sophisticated and highly polished releases are a big deal, and I will be writing about them in detail in coming weeks and months. But ultimately, operating systems such as Vista and Leopard will diminish in importance.

For the past quarter-century, there has been a trend toward ever more complex software running on ever more powerful computers. In 2006, Web-based programs that can run on less powerful computers and simpler software began to emerge as serious contenders. In place of Microsoft Office, we may soon see people adopting productivity suites from Google, startup Zoho, and others—at least for use in homes and schools. Web-based programs have always had one big drawback: an inability to work when not connected to the Internet. But in the coming year, such programs will acquire richer features and become more useful, even when you are offline.

The important point is, Web programs need only a browser to work. The more popular they get, the less relevant Vista and Leopard, with all their fancy new bells and whistles, become. And because the new Web programs are all based on industry standards, even the choice of a browser is less important. For the past 10 years, Microsoft has designed all of its Web efforts to favor its Internet Explorer browser. But the new programs bundled under Microsoft's Office Live brand are designed to work equally well on IE and Mozilla's Firefox.

How Microsoft's Vista and Apple's Leopard will fare

TOO BAD THIS SPIRIT OF COOPERATION and commitment to standards has not spread to digital entertainment, which promises to be another hot area. In September, Apple said it was building a product code named iTV. It's designed to bridge the chasm between the Net, where lots of digital movies and video are available, and TV sets, where most people want to watch this content. The product is due out in early 2007, but we still don't know much about its capabilities. My guess is that it will be at best a partial solution, limited to video that either has no copy protection or is purchased from the iTunes Music Store. Apple, like ne everyone else in the business, wan to keep content within the walls o store and its players.

One result of this approach is th a consumer who wants to watch th same content on a TV, a PC, and a handheld may end up paying for it three times. This is stifling the grow of digital entertainment, and the situation won't improve much in 2 Far more content will be available the Internet, but watching it isn't g to get much easier. Real progress v require a major collaborative effort among the companies that cre computers, consumer electron and entertainment, which doe seem to be in the offing.

The picture is a lot happier the wireless arena. Whether y looking for e-mail on a handh or video streamed to a laptop, choices are going to get both numerous and better. Many c Philadelphia and San Francis being the largest, are building extensive municipal Wi-Fi networks that will work with laptops and a growing numb handhelds. Verizon Wireless and Cingular are expanding high-speed data networks, and Sprint is rolling out a netw upgrade that provides true mobile broadband.

Of course, technology tools and toys are only one aspe of our lives and far from the most important one. As in p years, I want to end 2006 by wishing all of my readers a happy, healthy, and prosperous New Year. ■

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MediaCentric
BY JON FINE

The New Sport of Billionaires

These are dangerous times for the tattered local newspaper. The moguls a descending. ¶ Jack Welch and *The Boston Globe*; David Geffen et al in Los Angeles; potential suitors for the *Baltimore Sun*, the *Hartford Courant*, and *Newsday*; former AIG Chairman Hank Greenberg circling The New York Times Co., which has a dual-stock structure designed precisely to ward off

people like Hank Greenberg. This far into the mogul boomlet, exactly one local business biggie has trotted off with a newspaper. (That would be Brian Tierney, leader of a local consortium that bought Philadelphia's two dailies, and who may be morphing from heroic exemplar to cautionary tale. But more on that later.) If there is one clear lesson, it's this: There is no easier way for a rich dude to get his name in the paper than to announce he wants to buy it. Actually operating the thing—well, that's another story. What do wannabe barons need to know that they don't already know? "Everything," says Mort Zuckerman, who bought New York's *Daily News* in 1993. A primary misconception among those with healthy egos and scads of cash is that their smarts are scalable to anything. As one Wall Streeter cracks, newspapers' newest suitors are billionaires trying to become millionaires.

YOU CAN'T PLAUSIBLY CLAIM that newspapers don't need well-heeled outsiders or that their top managers have been doing just fine. With few exceptions, they've done terribly. The industry has yet to halt the migration of ads and readers. In an age when advertisers clamor for more and better information on customers, newspapers have done a remarkably poor job of gathering demographic data on their readers. (Tierney, admirably, says he's determined to fix this.) Newspapers are another industry that proves the downside of being run by a clubby group of insiders. But there is at least one key reason why outsiders should think twice about coming in to shake things up. Unlike a baseball team—speaking of an industry run by clubby insiders—the value of a newspaper won't increase as financial indicators tank. And the pool of greater fools is drying up.

Six months after his purchase, Tierney is furiously chasing steepening revenue declines with expense cuts—necessary, he has said, to ensure the paper can make its debt payments.

Moguls are drawn to newspapers like moths to a flame

As noted, Tierney is saying smart thi about what newspapers could do to thrive. But he also might not need to cut so deeply had he not spent, and borrowed, so much for the papers in first place. Most papers are monopol with still-sizable cash flow, so it's unlikely suitors will be able to pull a Zuckerman and get a major daily for cheap—as he did when he snatched the *Daily News* for $36.3 million, or about 7% of what Tierney paid in Philly. That low price undoubtedly made the tougher parts of the job, li dealing with unions, go down easier (Captains of industry do need hobbi but you'd think they could find one that isn't staffed with unioni employees.)

The road that Zuckerman the *News* have traveled has n been easy, but the marriage h remained solid. This is more than you can say for two form owners of the *New York Post*, which in the '90s was briefly the portfolios of Steve Hoffer and then Abe Hirschfeld. Both stints ended quickly, an Hoffenberg and Hirschfeld ended up in prison—though before each started up another short-lived newspaper aft leaving the *Post*. The dream dies hard. Ask the retired ba Joe Allbritton. He once owned the now-defunct *Washing Star*. Today his son is at work building out a D.C.-based mini-media empire including—you guessed it—a newsp one covering Capitol Hill. Evidently, when it comes to newspapers, the mania gets passed down to the sons, an even they know when to say when. ■

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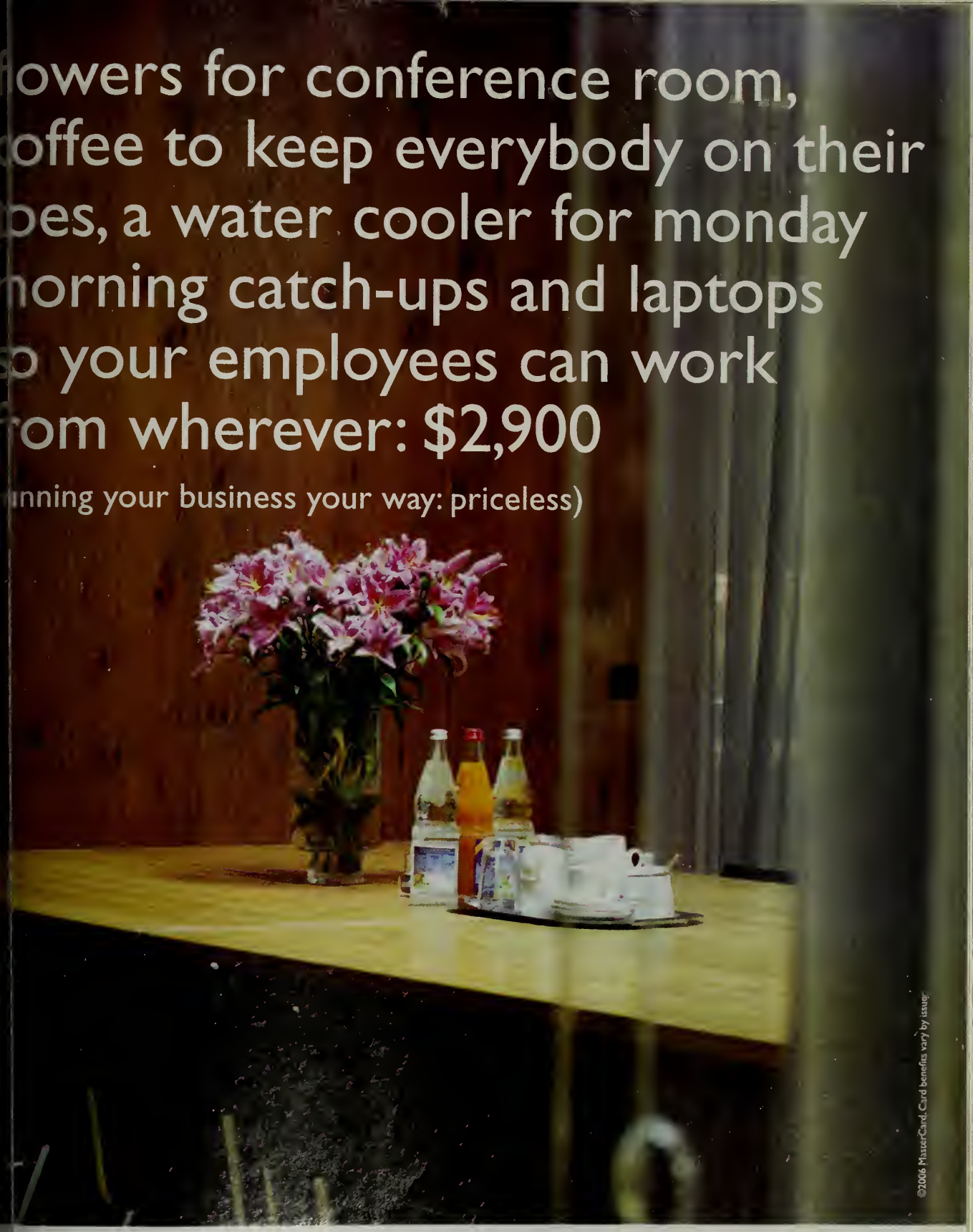

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A Wealth of Infor

AMES C. COOPER

ount on Consumers o Keep Spending

expect a more moderate pace as job growth and wealth gains slow

U.S. ECONOMY With the holiday buying season in full swing and economy cooling off, all eyes are on U.S. consumers, and the ch will continue well into the new year. That's because household nding has played a major role in the economy's resilience over the t year, and the economy will need plenty of support from

mers in 2007 as the housing slump continues to big bite out of overall growth. Will households be he task?

answer is yes, but don't expect the shop-till- rop pace of recent years. Spending growth after ing for inflation has already slowed from its peak about 4% in 2004. Consumer outlays grew about is year, and the pace next year might well be a below that. In the coming year consumers will support from the same two factors that buoyed ing in 2006: gains in income and wealth. They just be getting as much.

t hardly means consumers—and the economy— aded for trouble. In fact, the forecasters in *ssWeek*'s annual outlook survey see the economy ing along at a slower but steady clip throughout page 62). And they believe consumer spending will ue to provide ample support.

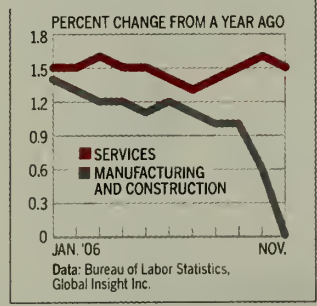
CONSIDER THE LABOR MARKETS. The Labor said the economy continued to generate plenty and wage income in November. Payrolls rose by 0 last month and, in what has become a regular this year, Labor revised payrolls in September tober upward by a net 42,000 jobs.

, hiring has slowed. Through November, monthly ns in 2006 have averaged 149,000 jobs per month, e less than the 165,000 average in 2005. Further g seems likely, as the current weakness in housing nufacturing works its way through the economy y 2007. And as hiring slows, so will income gains. rdrooms already are a bit more somber on nic prospects for 2007, based on the fourth-quarter conomic Outlook Survey from the Business table. The executives anticipate steady growth irst half of the new year, but the Roundtable's nic Outlook Index, which assesses future sales, spending, and hiring, has declined for three utive quarters, to the lowest level in more than ears. Only 37% of CEOs expect their company's s to rise in the next six months, while 40% see no , and 23% anticipate a decrease.

For now, wage and salary income is holding up well in the fourth quarter, especially after factoring in the boost in purchasing power from lower gas prices. That extra buying power is giving a lift to holiday buying, as seen in the strong 1% rise in November retail sales from October.

However, if the economy is growing at a rate of about 2% in the fourth quarter, as many economists now believe, it will head into 2007 having averaged only a bit above 2% for three quarters in a row. That's slow enough to suggest the unemployment rate might actually tick up early next year, a factor that would only add to household uncertainty about prospects for jobs and incomes.

THE WEAKNESS IN PAYROLLS is concentrated in residential construction and manufacturing (chart). Since June, those two sectors have lost 174,000 jobs, and more losses seem probable in coming months. Because of the lags associated with the completion of projects under way, overall construction payrolls began to post significant declines only in October and November, down 24,000 and 29,000, respectively. With housing starts still falling in October, further big declines this winter are likely. Recent measures of construction output have fallen far more sharply than construction payrolls, suggesting more layoffs to come.



Manufacturing jobs are on a similar track. Factories are recling from an inventory adjustment precipitated by overbuilding in housing and overproduction in the auto industry. Now the pileup of inventories has broadened to other industries with ties to housing and autos. Manufacturers have shed 95,000 workers since June, and factory output shows no sign of strengthening amid recent declines in new orders and production.

So far, though, job growth in service industries, which

account for four-fifths of all payrolls in the private sector, is offsetting the weakness in the housing and goods-producing industries. Service payrolls, which increased by 172,000 in November, have posted average monthly gains of 146,000 in 2006, a tick faster than the 143,000 monthly clip in 2005. The health-care, business-services, and leisure and hospitality industries have led those gains.

THE STRENGTH OF THE JOB MARKET in 2007 will be increasingly important in the consumer outlook because households will have to depend more on income growth for their purchases in the coming year and less on gains in their wealth. Rising home prices have added handsomely to net worth in recent years, but additions to household wealth will not be as large in the coming year as they have been. Softer home prices will see to that, which also means consumers will be more dependent on financial assets for gains in wealth, which could put their sense of well-being at the mercy of stock prices.

Wealth gains have been a key reason why consumers have allowed their savings to dwindle to record lows in relation to income. Increased wealth has been a substitute for traditional savings. That trend was clearly in evidence through the third quarter of 2006, as the Federal Reserve reported a $776 billion rise in household net worth—comprising all assets minus liabilities—from the second quarter, to a record $54.1 trillion.

In the coming year households will not be able to save as much in terms of their wealth gains, and they may choose to set aside more of their income, leaving less for spending. The Fed's numbers show the waning influence of real estate wealth on the total (chart). Housing net worth—real estate values minus home mortgages—ba rose, by $14.5 billion, in the third quarter, the smallest quarterly rise in 12 years. Housing net worth will almc certainly turn negative in coming quarters as home va fall further, but also note that real estate values have doubled in the past seven years.

HOUSING'S WANING BOOST TO WEALTH

Data: Federal Reserve, Global Insight Inc.

Financial assets provided almost all the third-quarter ris in net worth, especi stock market gains. The value of corpor equities, mutual fun shares, and pension fund reserves rose b $539 billion, and ar even larger increase in the fourth quarte seems likely. Through mid-December, the Dow Jone Wilshire 5000 Index was up 6.5% from the end of tl third quarter, when it rose 4% from the second qua

By and large, consumers are in good financial shape heading into 2007, as evidenced by still-low delinquency rates for most types of loans, the subp mortgage market being the exception. Unless job growth grinds to a dead stop, which seems unlikely household finances should remain broadly healthy enough for consumers to keep spending at a slowe steady pace in the coming year. ■

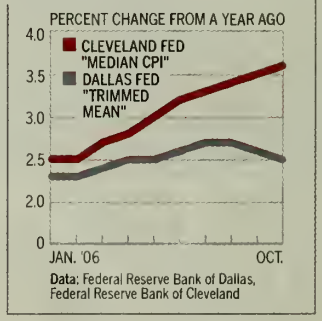
INFLATION

Two Price Gauges That Hardly Look Tam

THE FEDERAL RESERVE continues to keep a hawkish eye on inflation. While top-line readings of price indexes have shown marked slowdowns, alternative inflation gauges show prices still running at an uncomfortable pace for the central bank and that the gains remain broad-based.

After the Dec. 12 monetary policy meeting, Fed Chairman Ben S. Bernanke and his fellow policymakers stated once again that "some inflation risks remain." While the Fed expects price pressures to ease due to slower economic growth and lower energy prices, it hasn't ruled out another interest rate hike.

PERVASIVE PRICE PRESSURES



Data: Federal Reserve Bank of Dallas, Federal Reserve Bank of Cleveland

One reason the Fed still sounds tough is continued evidence of a broad entrenchment of price pressures, including two unofficial inflation indexes: the Dallas Fed's trimmed mean index and the Cleveland Fed's median consumer price index (CPI).

The Dallas Fed uses data from the personal consumption expenditure price index, the central bank's preferred inflation gauge. It then removes, or trims, the components with the biggest monthly ups and downs, eliminating extremes and providing a clearer underlying trend.

For October, this index showed prices for a majority of goods and servi rose at an annual rate of 2% or m for a 10th consecutive month. Th kept the yearly pace at 2.5%, abo the Fed's comfort zone of 1% to 2

The Cleveland Fed's median C ranks the index components in ascending order. It then uses the middle category for its monthly change. This gauge shows prices October rose 3.6% from a year a vs. 2.7% in the core CPI.

"The message contained in bo of these alternative price measur that the underlying trend in infla continues to climb," wrote ABN-AMRO Bank chief U.S. economis Steven Ricchiuto in a Dec. 8 rese note. So even if the economy continues to run at a slower pace Fed will likely see little reason to interest rates in the first half of 2 as the markets now expect. ■

–By James Mehring in New

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News you need to know

EDITED BY HARRY MAURER

Carriers on the Prowl The airline industry is testing a new propellant: the merger. Just 11 months after exiting bankruptcy, **United** is in early-stage talks with **Continental** about forming what would be the nation's biggest carrier. Meantime, management at bankrupt **Delta** is fending off an unsolicited bid from **US Airways. Northwest,** also in Chapter 11, has hired advisers to put together a deal, and discounter **AirTran** on Dec. 13 offered $290 million for **Midwest Air.**

So far, though, all this talk of consolidation is just so much exhaust. And while airlines are nervously watching each other's maneuvers, it may never amount to more than that. United **CEO Glenn Tilton,** for example, has coveted Continental for years, but discussions have never advanced because neither Tilton nor Continental **CEO Lawrence Kellner** wants to give up his job to the other. Northwest also has a partnership with Continental that allows it to block a takeover.

ONLINE *See "Airlines surge on talk of deals," www.businessweek.com/go/tbw*

The Fed Holds Fast **Federal Reserve** rate-setters keep playing tough. On Dec. 12 they voted to keep the federal funds rate at 5.25%. And although they noted the "substantial cooling" of the housing market, they didn't even entertain the notion of lowering borrowing costs. The only issue they raised is "the extent and timing of any additional firming."

See "Count on consumers to keep spending," page 29, and ONLINE *"The Fed hedges, citing housing woes," www.businessweek.com/go/tbw*

Talking Turkey in China Just days after Beijing ebrated China's entry into the **World Trade Organization,** an precedented group of U.S. Cabinet officials led by **Treas Secretary Henry Paulson,** along with **Fed Chairman Ben Bernar** headed for China for meetings on Dec. 14-15. At issue w the usual suspects: a U.S. trade deficit with China expec to top last year's $202 billion, poor intellectual-prope rights protection, and concerns over market access. Wl Washington will continue to argue that the yuan is unc valued, Beijing probably won't budge.

See "Hank Paulson on China and the year ahead," p 162, and ONLINE *"U.S.-China talks: Don't expect the wor www.businessweek.com/go/*

Take My Oil Field, Please Four-fifths of the way tow completion of the $20 billion **Sakhalin 2** oil and gas me project on an island off eastern Russia, **Royal Dutch Shell** offered to give up control to energy giant **Gazprom,** repo Reuters on Dec. 11. Moscow has been nagging Shell ab cost overruns and environmental disputes. Shell says n ing has been agreed on, but it's clear Gazprom will enc with a big share. Compensation could come in cash ar share of Gazprom gas reserves in Siberia.

Kent Is It Does **Coke** have its next CEO in the can? Th the betting after the soda king on Dec. 7 named **Muhtar** as president and chief operating officer, a post that been unfilled for more than two years. The move was wi anticipated given that Kent, who most recently heade Coke's vast international operations, had worked clo over the decades with **CEO Neville Isdell.**

Gunning for the LSE **Robert Greifeld, NASDAQ's** tenac boss, has all but given up on the leaders of the **London S Exchange** and on Dec. 12 unveiled a formal hostile off $5.3 billion. The stock has soared ever since NASDAQ s ed buying it up a few months ago. But the LSE conti to display a stiff upper lip, saying the offer "substant undervalues" the bourse and telling investors to sit t As of Dec. 13 the stock was about 6% higher than NASD offer, so traders seem to be banking on a richer price.

See "Unsolicited aggression," pag ONLINE *and "NASDAQ gets hostile in Lond www.businessweek.com/go/*

Citi's New Cost-Cutter For months, Wall Street been hammering **Citigroup CEO Charles Prince** and the pany's stock for boosting expenses faster than rever So on Dec. 18, Prince announced that he's promoting time loyalist and investment banking chief **Robert Dr** to the position of chief operating officer. Filling a pos vacated about a year ago by **Robert Willumstad,** Druskin put expenses under a microscope. Where's the mast cost control, **Sandy Weill,** when you need him?

Options Watch Just when you thought it couldn' worse, another cranny in the options backdating sca

ning under increased scrutiny. *The Wall Street Journal* ec. 13 reported on an SEC study that says some execu- appear to have changed the dates they exercised their ns to days when the stock price was low. That would the effect of lowering their tax bills.

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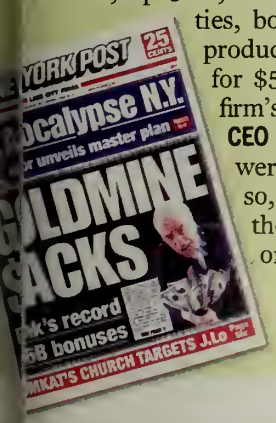
ice Makes Nice Corporate fraud investigators will ined in a tad by the Justice Dept. **Deputy Attorney General McNulty** said on Dec. 12 that prosecutors will have to thumbs-up from him before asking companies to turn confidential communications with their attorneys. cent years, corporations that refused such requests ased their risk of indictment, a practice now scrapped. vill the Feds hold it against companies that pay legal of employees charged with a crime. These post-Enron ball tactics had evoked howls of outrage from business cates and defense attorneys. Some say the changes still go far enough.

ONLINE *See "Justice softens investigation guidelines," www.businessweek.com/go/tbw*

Settles Closing one chapter of its boardroom-leak lal, **Hewlett-Packard** agreed on Dec. 7 to pay $14.5 mil- o end a suit brought by California's attorney general. uit accused the company of unfair business practices it hunted for the source of media leaks. The settle- didn't include any admission of liability, but HP isn't f the legal woods; five former HP executives and out- umshoes still face criminal charges. And on Dec. 13 revealed that two Democratic members of Congress sent HP **CEO Mark Hurd** a letter inquiring about stock ns he cashed in for $1.37 million just before the pre- g scandal hit headlines.

Bonanza of the Week

ldman Sachs simply printed 10,000 $20 bills an hour, ours a day, 365 days a year, in the basement of its road St. headquarters, it would take nearly six years he firm to turn out as much money as it did through ing and dealmaking in the last fiscal year. The tony said on Dec. 12 that it earned $9.54 billion, a 70% over fiscal 2005 and a record for an investment , on revenues of $37.67 billion, up 49%. Trading the big engine: Goldman logged $25.56 billion of evenues, up 52%, from buying and selling equities, bonds, derivatives and other products. Dealmaking accounted for $5.63 billion, up 53%. In the firm's typically reserved fashion, **CEO Lloyd Blankfein** said partners were "very pleased." Even more so, no doubt, when they opened their bonus envelopes starting on Dec. 13.



ONLINE *See "All that glitters is Goldman," www.businessweek.com/go/tbw*

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TAKEOVERS

UNSOLICITED AGGRESSION

A barrage of hostile bidding, fueled by mountains of cash, is sweeping the globe. Buckle up, CEOs

BY EMILY THORNTON

LONNIE "BO" PILGRIM wears a broad-brimmed black pilgrim's hat and brings along a stuffed chicken named Henrietta when he makes public appearances. On his lighthearted Web site, "Bo's World," video clips show Pilgrim leaping out of airplanes with live chickens in jump gear. And he talks on the site about the virtues of raising chickens in little country towns.

In many ways, Pilgrim, the 78-year-old chairman and founder of chicken producer Pilgrim's Pride Corp. in Pittsburg, Tex., would seem to be an unlikely person to launch a hostile takeover bid. Nevertheless, Pilgrim started a brutal chicken fight when a rival, Atlanta-based poultry processor Gold Kist Inc., refused to sell out to him in February. Instead of giving in, Pilgrim launched a four-month-long proxy battle to appeal directly to shareholders. On Dec. 4, Gold Kist's board capitulated, agreeing to sell the company to Pilgrim for $1.1 billion.

Pilgrim's Pride is now America's largest chicken producer, ahead of Tyson Foods Inc. And the company's management team describes their relationship with Gold Kist as cordial. The hostile bid "might not have been friendly to members of the board or management," says Chief Financial Officer Richard A. Cogdill, but "our proposal was very friendly to shareholders." (Pilgrim's Pride is paying $21 per share for Gold Kist, a 62% premium over the price on the date of the initial bid.) Bo Pilgrim declined to comment.

Watch out, CEOs: Takeovers are turning hostile—again. Pilgrim's unfriendly offer is only one of a barrage of unsolicited takeover bids hitting executive suites globally. In polite Japan, two paper companies recently duked it out. In Sweden, truckmaker Scania is fighting off a bid by German rival MAN. On Dec. 12, NASDAQ formally made a $5 billion hostile bid for the London Stock Exchange. Some companies are even enlisting the assistance of hedge funds and unions to pour on the pressure. Meantime, private equity groups are becoming more pushy, busting in on each others' deals, and occasionally making hostile offers themselves.

Add it all up and in 2006, corporate and private equity buyers worldwide lobbed 110 uninvited bids worth $351 billion at acquisition targets. That's the highest number since 2000, when 129 offers worth $117 billion were launched, according to Thomson Financial. And there have been big deals, like Rotterdam-based Mittal S Co.'s $41.5 billion hostile bid for r Arcelor, which Arcelor's board ultima approved after it was sweetened a co of times.

This year, buyers fired off 110 uninvited bids worth $351 billion

Bankers don't expect the wave of ho ity to crest any time soon. Companies financial buyers awash in cash are anx to put their money to work while int rates remain low and financing is pl ful and cheap. The industrial compa in the Standard & Poor's 500-stock i alone have built up $610 billion in on their balance sheets, nearly twice $329 billion they had in 2000. Privat uity firms have amassed at least $2 tri of buying power, bankers estimate.

At the same time, many compa look more vulnerable than ever after ing stripped out their takeover defens satisfy good-governance mands. Only 118 compa adopted so-called po pill plans in 2006, comp with 234 on average year in the '90s, accordi Thomson. As a result, d tors are more responsi outside offers. "When panies are approached, ten invites a lot of rumo speculation, and somet it's difficult to put the

NEUBECKER

back in the bottle," says Paul J. Taubman, global head of mergers and acquisitions at Morgan Stanley.

BUY OR BE BOUGHT

MANY EXECUTIVES are making unsolicited bids for companies because they believe they must buy their rivals or risk being bought out as their industries consolidate. When Warner Music Chairman and CEO Edgar Bronfman Jr. was asked at an investors' conference on Dec. 5 why the company launched a hostile bid for EMI Group over the summer after EMI made an unwelcome bid for Warner Music Group Corp., he explained: "We decided that if there was to be a combination, we actually could create more value for our shareholders in an acquisition of EMI than going the other way." The two sides recently ended the volley, fearing the combination would not fly after European regulators began another review of a merger between Sony's music division and BMG.

That same fear prompted AirTran Airways to launch an unsolicited $288 million bid for Midwest Airlines on Dec. 13 after Midwest refused to engage in private merger talks. "You can debate the merits of consolidation, but if it happens, no one wants to be left out," says AirTran President Robert L. Fornaro.

Besides, investors are rewarding hostile moves. The stock price of Pilgrim's Pride, for example, zoomed 12% after it announced a victory over Gold Kist. "Unlike earlier merger waves, hostile deals have been well received by the market, in part because they are more strategic now," says Stefan M. Selig, vice-chairman for global investment banking at Banc of America Securities, the investment banking arm of Bank of America Corp. Another reason is the larger role hedge funds play in shareholder bases. "Hedge funds can typically become a proponent for the highest offer, rather than a proponent for keeping a company independent," says Goldman, Sachs & Co.'s Gordon E. Dyal.

Take into account all of the incentives, and it means that a deal is no longer a deal. Analysts speculate that a hostile bidder like Australian mining giant BHP Billiton may soon swoop in to bust up a friendly $25.9 billion merger that Freeport-McMoRan Copper & Gold Inc. unveiled with copper miner Phelps Dodge Corp. in November. And there's talk that an airline, possibly partnering with private equity groups, might try to crash US Airways Group Inc.'s $15.8 billion hostile bid for Delta Air Lines Inc. when the company files its formal plan of reorganization by the end of December.

Anything can happen. Just ask Dave Crane. The CEO of New Jersey energy provider NRG Energy Inc. thought he had an understanding with Edward R. Muller, the CEO of rival Mirant Corp. in Atlanta, that the companies would go their separate ways after they decided against a "merger of equals" in early May. But a few weeks later, Muller walked up to Crane at a Goldman Sachs energy conference and handed him a letter informing him that Mirant was launching an unsolicited $16 billion bid for NRG—the largest uninvited bid in the U.S. this year. "It was an extremely bold move for a company only out of Chapter 11 for three months to buy a company that's larger than them," Crane says.

NRG fired back a blistering letter saying that it wasn't interested. Then Mirant sued NRG for failing to consider its offer. And NRG accused Goldman Sachs, which it had used earlier for banking work, of passing along confidential information to Mirant. Goldman denied the allegations. Finally, Mirant backed down when it came under attack by activist hedge fund Pirate Capital. Pirate insisted that if Mirant didn't put itself up for sale it w try to take control of Mirant's bo Pirate declined to comment. Mirant not return phone calls.

In some of the nastier battles, execu are hurling insults at their foes. On D Leif Ostling, CEO of Swedish truckm Scania, described a $13.6 billion ho bid by German truckmaker MAN "blitzkreig" in an interview, and comp his defensive role at Scania to tha Winston Churchill defending Britain the Nazis. Ostling later apologized fo remarks, which outraged MAN mana and German politicians, all the mo since MAN's CEO, Hakan Sa elsson, is a former Scania ex tive and a Swede.

In Chicago, James P. Bo ard, CEO of steel distrib Esmark Inc. accused Braz steelmaker Companhia Sid gica Nacional and the mar ment of Wheeling (W.Va.)-b Wheeling-Pittsburgh Steel (of attempting to buy "an Am can steel producer with a r and a gun," in a letter filed the SEC after Wheeling-l burgh resisted Esmark's million hostile bid. The Virginia company had alr agreed to merge its plants the Brazilian steel maker's N American assets. The Braz steelmaker declined to com on Bouchard's letter.

Bouchard didn't stop t He solicited the support o United Steelworkers of Am and hedge fund Tontine Ca Management, owner of a stake in Wheeling-Pittsbu With their support, Bouc was elected Wheeling-l burgh's CEO on Nov. 17. Its board, led by Bouchard, review both Esmark's offe the merger plans in Januar

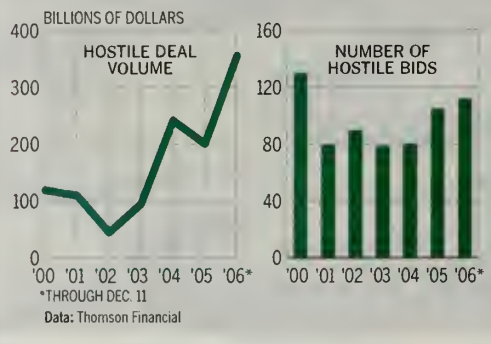
Even founders are ma hostile bids for the companies they ated. On Nov. 17, Jerry Moyes, founc Swift Transportation Co., launched a invited offer to pay $29 for Swift's sh which had been trading around $23 board rejected Moyes' bid 10 days But analysts expect him to come bac fight another round. "You'll have a upset shareholders if there is no c says Chaz Jones, research analyst at gan Keegan & Co. ■

–With Dean Foust in Atlanta Edmondson in Frankfurt, Tom Lo New York, and bureau re

CHICKEN KING Pilgrim now rules the roost

GETTING HOSTILE

Companies and private equity firms are launching more hostile bids for larger companies worldwide



*THROUGH DEC. 11

Data: Thomson Financial

NO PLACE TO GO The Rimstads defaulted after late charges and interest piled up

DING

HE 'FORECLOSURE ACTORIES' VISE

le predatory tactics of some mortgage vicers are squeezing homeowners

ARA DER HOVANESIAN

RANDY AND JENNIFER Rimstad of Minnetonka, Minn., refinanced their mortgage in 2004 to replace a 50-year-old furnace and pay for their youngest daughter's wed-ng n May, their interest rate jumped to 55 from 5.55%, pushing their monthly ym nt from $1,654.81 to $2,295.68, and e Rnstads buckled under an adjustable te rtgage they say they didn't under-and nd could ill afford. Then came the le on nightmare that tacked on an-her 700 or so in monthly payments.

On Dec. 5, Option One Mortgage orp a Kansas City (Mo.)-based unit H R Block Inc., foreclosed because e Rnstads owed more than $18,000 la charges and attorney's fees, on p o heir past-due payments. After 24 ars nder the same roof, the Rimstads ce uncertain future. "I don't know what will happen to us," says Randy, 57. "We don't have any place to go." Option One says it can't comment on the specific amount owed, but that it has been working with the Rimstads and will continue to "explore options toward a solution."

Millions of other families in the U.S. could soon find themselves in the same dire straits. Some $1.2 billion in adjustable mortgages will shift to higher rates in 2006 and 2007, more than half of which are to borrowers with less-than-perfect credit, or subprime borrowers, like the Rimstads. These loans already are defaulting at unprecedented rates. Lenders are in large part responsible because they sold risky and unsuitable mortgages to unsophisticated borrowers. In some cases, of course, careless borrowers shoulder some of the blame. But some say there's another force at work: aggressive servicing tactics. "Predatory servicing has attracted little attention, yet in many respects it is more vicious and the adverse consequences are more far-ranging," says Jack M. Guttentag, professor of finance emeritus at the the University of Pennsylvania's Wharton School.

> HUD is bracing for a lot more complaints

Mortgage servicers collect and record monthly payments as well as manage insurance and tax payments on some $10 trillion in mortgage debt outstanding. They also manage defaults and collections when loans go bad. Critics of the industry, such as Rawle Andrews Jr., a bankruptcy attorney with Andrews & Bowe in Washington, call them "foreclosure factories."

Servicer abuse is not new. Still, regulators had hoped the industry would have cleaned up its act since 2003 when the Federal Trade Commission and the Housing & Urban Development Dept. slapped a record $40 million fine on Fairbanks Capital Corp. in one of the worst cases of predatory servicing, which involved many of its 500,000 customers. Says Kurt Eggert, a professor at Chapman University School of Law in Orange, Calif: "The FTC hoped by nailing Fairbanks it would send a message to the whole industry. It hasn't yet."

SOFTWARE GLITCHES

ANY NUMBER OF predatory practices, from not crediting payments to prematurely initiating foreclosure proceedings, can send struggling home buyers over the edge. "In the subprime market, it's a huge deal because they're already in a loan that is very expensive. If you live paycheck to paycheck, the penalties of delinquency sink you deeper," says Alfred Ripley, legal counsel for consumer and housing affairs at the North Carolina Justice Center in Raleigh, a nonprofit that helps low-income families statewide.

Ivy Jackson, a director at the Housing & Urban Development Dept., is bracing for a lot more consumer complaints. "The speculation is the servicers don't

have enough people to handle the volumes. We're hearing that they're not set up to service [exotic] loans."

Bureaucratic snafus and software glitches are no small problem in the servicing industry. Huge errors stem from the massive turnover of ownership alone. Servicing rights for any individual mortgage are valued separately from the actual loan and are often sold repeatedly by banks and third-party servicers without customers having a clue or a choice.

Still, there is no rule that says the old servicer must transfer the entire record to the new servicer. Often borrowers aren't informed of a change, and they use their original payment coupon book and send checks to the old address. The checks usually get sent back to the borrower, while the new servicer chalks it up as a late payment, deducts a penalty from the mortgage, and marks it as underpaid. After a few months of this, the loan is recorded as delinquent. But the customer may not know anything is wrong because servicers aren't required to send a statement, and if they do, it is often incomplete. A foreclosure notice can be the first indication of any trouble. One HUD investigator says in a recent case a borrower faced foreclosure because 19 mortgage payments were missing. "The servicer found all 19 payments in what we call 'a miracle' because we got involved," says the investigator.

'A TERRIBLE ABUSE'

OTHERS AREN'T SO LUCKY. Consumer lawyers say the system preys on the ignorance of borrowers and creates an opportunity to add false fees and charges not authorized by law or their mortgage contract. "The subprime servicer has found the perfect class of people with spotty credit records who are less likely than others generally to stand up for themselves," says attorney Robert C. Hilliard, a partner with Hilliard & Munoz in Corpus Christi, Tex. "And they are relentless about scaring the living daylights out of these people."

Hilliard has brought four cases against West Palm Beach (Fla).-based Ocwen Financial Corp., which, with a $50 billion portfolio, is among the 10 largest subprime servicers. (Two were successful, one was dismissed, and a fourth is in early stages.) In one case, a Galveston County jury in Texas awarded Sealy Davis, a widowed grandmother who was a nurse's aide at a children's hospital, $11.5 million after finding that Ocwen committed fraud in servicing her home-equity loan. Ocwen's general counsel, Paul Koches, says an offer to cancel the entire debt and permit Davis to keep her home was rejected early on. "They were bent on a litigation strategy to play the jury sympathy card against a deep-pocket defendant," he says. The case is on appeal.

HARD-PRESSED Allen filed for bankruptcy after her penalties for late payments ballooned

Paying on time isn't enough to protect customers from some wily servicers. A servicer might even pocket an extra payment and never credit it to a borrower. "I have audited loans where the consumer has made all payments on a timely basis, and yet the servicing company manufactured a default and, in some cases, completed a foreclosure," says Marie McDonnell, an Orleans (Mass.)-based mortgage finance analyst who specializes in the auditing of mortgage loan

For borrowers with fi cial woes, the servicing ma the most difficult to navig Fifty-seven-year-old Lynd len, who makes $51,00 year, says her monthly checks were erratic in 2 and she fell behind. When tried to come clean and n good with Houston's Li Loan Servicing, she says company billed her $33, including penalties, to c four monthly mortgage ments that would have tot $13,000 otherwise. She pays Litton, but filed pers bankruptcy four years ag protect the home she has l in for the last 13 years. She f "they'll take my home" w she emerges from bankrup

Litton says it won't c ment on specific loans because of pri issues. But given the surge in defa the pressure is high to keep peopl their homes, says Larry B. Litton chief executive of Litton Loan Servic which services loans worth $60 bil "We are...trying to lower credit lo The last thing we want to do is raise bar and make it more expensive for rowers to stay in their homes." L says the company can lose up to 50 the dollar if loans go bad, and is wi to renegotiate interest rates and w fees. "If a consumer is really motiv to keep their home, nine times out we can help that borrower stay in home," he says.

Not all players are so generous. Donnell says when a consumer runs some trouble causing him or her to b for just one payment, the default written into the servicer's software ap to drive the loan mercilessly toward closure. "It's as if there is zero tole for a delinquency, so that a payment past the grace period is recognized default. At that point, payments ar fused," she says. McDonnell is fighti rescind the Rimstads' loan under all violations of the Truth in Lending Ac

This Is Service?

Some mortgage companies engage in aggressive servicing tactics. Here's how:

1 RECORDING timely payments as late and imposing fees	**2 REFUSING** payments that are pennies short, then charging late fees	**3 PAYING** property taxes late and charging the borrower	**4 CHARGING** homeowners for extra insurance
5 DISREGARDING written requests for account balances	**6 SUBJECTING** customers to verbal threats by agents and attorneys	**7 EARNING** interest on extra payments made toward principal rather than crediting the client	**8 SENDING** accou to collections aft as few as two payme are delinquent

Data: Washington law firm Andrews & Bowe, Jack M. Guttentag, professor of finance emeritus at the Wharton School of the University of Penn

vicers have also been known to tack arges for insurance that isn't required at the homeowner already has. The mer remains oblivious because he or oesn't get a statement. Then when nortgage payment isn't enough to the new policy, the entire mortgage ent gets placed in a so-called sus- account. The servicer then reports orrower as delinquent and charges a e. Says Guttentag: "They should re- he payment and record a deficiency escrow account, which they are en- to do. But to make the payment late se they put it in the escrow account ny view a terrible abuse."

h may have been the case with sa Gholson of Dinwiddie, Va. Her ey, Dale Pittman, says 98 differ- ople at Chase Home Finance tried rt out why Chase bought flood nce for Gholson unbeknownst to nd then marked her delinquent harged her late fees when her regular mortgage payment wasn't enough to cover the new policy as well. Eventually, Chase, a unit of JPMorgan Chase & Co., refused her mortgage payments because it wanted her to pay the delinquent amounts. Next, it hired a law firm to pursue foreclosure. A Chase spokes- ays the bank purchased Gholson's age from another lender, and the ct indicated that she needed flood nce. Gholson says she lives no- near a flood plain. After 2½ years ting, Chase settled with Gholson ember for $25,000, including legal ays Gholson, 43, who works three pay $721 a month for her $86,000 edroom house: "I work too hard to m take my house from me."

icers hey to lts

ics argue the fundamental business ics of servicing inspire wrongdoing. onsumers have no choice about who p as their servicer, so market forces ush servicers to compete on qual- o, while some banks hold servicing along with loans, others are sold to arty servicers who don't have the ncentive to maintain a good relation- order to sell such other products as ing account or investments. Says Carolina attorney Ripley: "It's a turn for that buyer, so if they want t to perform, they have an incentive rate as much fee income off of each possible." ■

AUTOS

HYUNDAI: TOO FAR, TOO FAST?

Korea's strong currency and costly moves to improve quality are making its cars pricier

BY MOON IHLWAN

GLOBAL CARMAKERS have become accustomed to Hyundai Motor Co. looming large in the rearview mirror. In recent years, no other major automaker has boosted sales and quality as fast as the Korean company. But that upstart in the mirror may not be as close as it once appeared.

ACCENT Toyota's Yaris is cheaper

Hyundai has been beset by poor productivity and shrinking profits. Net earnings for the quarter ended in September plunged 47% from the same period last year, to $307 million, on revenues of $6.4 billion. Sales in the U.S. fell to 28,417 vehicles in November, their lowest level in 22 months, cutting Hyundai's U.S. share to 2.4% from a July peak of 3.2%.

Hyundai's woes have been aggravated by the strength of the Korean currency. The won has climbed 10% against the dollar this year and 8% against the Japanese yen, which makes Hyundai less competitive against the likes of Toyota, Nissan, and Honda. Although Hyundai is raising prices to compensate, the currency's strength will still lop 2.7 percentage points off margins this year, says brokerage Prudential Investment & Securities. "The strong won has changed the whole competitive situation for us," says Hyundai marketing strategist Brandon Yea.

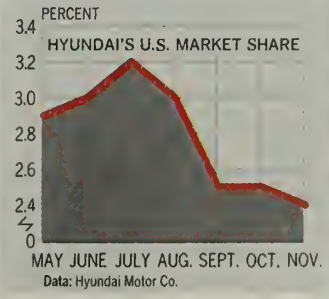
Americans aren't ready to pay a premium for Hyundais, no matter how great the quality. In the U.S., Hyundai's entry-level Accent now costs some $600 more than the rival Toyota Yaris. And U.S. sales of the Sonata sedan, which Hyundai began building at a Montgomery (Ala.) plant last year, have been disappointing. That's in part because a Toyota Camry today runs only about $1,000 to $2,000 more than a Sonata with similar trim. Three years ago, the difference would have been twice that. "They should have priced the cars lower to give them an edge," says Michael Marceca, business manager at a Hyundai dealership in Manhattan.

Hyundai is paying the price for strategic missteps that date back nearly a decade. As the won lost half its value against the dollar in the 1997 currency crisis, it seized the chance to spend big on quality. But with the won now back to pre-crisis levels, it's clear the quality drive came at the expense of productivity. Rather than improving the way it makes cars to minimize defects à la Toyota Motor Corp., Hyundai stepped up inspections and testing. The result: It needs two-thirds more man-hours to build each car than Nissan and Toyota do.

Hyundai says it can compensate for the rising won. It expects to make half its cars overseas by 2010, up from 30% today, and is dispatching engineers to suppliers' factories to help develop less costly parts. But its Japanese rivals are no doubt relishing the chance to put a little extra distance between themselves and the fast-moving Koreans. ■

–With Nichola Saminather in New York

STUCK IN REVERSE



Data: Hyundai Motor Co.

MOBILE PHONES

GOODBYE TO FREEBIES, HELLO TO FREEDOM

Cell-phone customers who are willing to pay more can switch carriers at will

BY CLIFF EDWARDS

RICKY DAVIS IS THE KIND of customer wireless carriers hate. On a recent visit to New York from Sydney, the film production assistant dropped into a wireless store and, bypassing phones with flashy names like BlackJack, RAZR, and Pearl, asked for a model for her husband that could be used with any number of service plans—just like her own $400 Nokia N70, purchased in Australia. Davis, 51, enjoys the freedom to travel almost anywhere without signing up for a two-year plan with one carrier that forces her to pay huge roaming charges on the road. "They factor the cost of the phone into the plan anyway, so you might as well just buy the phone you want," Davis says.

Nokia, Samsung, and other cell-phone makers wish the big U.S. phone companies felt the same way. They complain that some of their coolest and most profitable designs never see the light of day because Cingular, T-Mobile, and others keep tight control over which products they feature and what software can be placed on the phones they sell. In exchange for getting cheap phones subsidized by carriers—as much as $400 below cost—consumers usually forfeit the right to take that phone with them if they switch carriers.

But the era of the freebie phone may be coming to an end. In late Novem ber the U.S. copyright office ruled that it is not illegal for consumers to "unlock" cell phones they purchase from a particular carrier. The three-year exemption from potential wireless industry lawsuits strengthens the hand of Nokia and other manufacturers, which have begun quietly opening flagship stores in New York, Chicago, and elsewhere to sell phones like Davis' N70. Such moves risk alienating the wireless outfits, but cell-phone makers see the market shifting. Fewer than 5% of the 163 million handsets sold in the U.S. this year were unlocked versions. But analysts believe that could jump sharply in 2007 if Apple Computer Inc., as expected, soon announces an iPod-based phone with an unlocked option.

Market dynamics also are forcing change. Much of the growth for Nokia, Motorola, and Samsung is coming in markets like China and India. But the cheap phones they sell there are less profitable than the glitzy gizmos that browse the Web, take high-resolution photos, and play music.

Even with unlocked phones, there's less freedom in the U.S. Unlike in Eu and other regions, there are two typ cellular technology in America. Ci lar and T-Mobile use a global stan called GSM; to use their phones cus ers plug in SIM cards that store info tion about subscribers. Verizon (munications and Sprint phones have cards because they use a diff standard based on chips licensed or by Qualcomm Inc.

Every phone can be unlocked, because the two standards are in patible, a customer who buys a Treo from Verizon still could not to work with the Cingular plan. when you buy an unlocked phone, need to buy a wireless plan from a rier. You aren't forced into a cont though, and you don't have to p termination fee when you leave. Th could become yet more confusing the launch next year of Sprint N Corp.'s WiMAX wireless network. that Internet-based technology, all of WiMAX devices may be able to cheap voice-over-Internet calls.

If unlocked phones do take off, ers would benefit by not paying s dies, but they would be forced to com to offer the best services and fastest connections. That may spark price

Handset makers can't afford to c the carriers entirely. Even as Sam makes the $1,200 Serene phone for & Olufsen and Nokia sells its $650 8801 phone through Neiman Ma they hope to get more shelf spa Cingular and Verizon stores. The ers ultimately sell mobile Web se and are trying to lock in custome adding TV programming and You videos. "It's really hard to compete that, no matter who you are," say Fabris, director of wireless solutio Palm Inc. That won't stop manufact from trying, though. ■

–With Sonal Rupani in New

The Price of Liberation

"Unlocked" phones let you change carriers whenever you want, provided they use the same wireless technology. But they come at a cost:

PALM TREO 680

LOCKED, THROUGH CINGULAR WIRELESS

$199

(two-year contract)

UNLOCKED, PURCHASED AT A PALM STORE

$399

LG CHOCOLATE

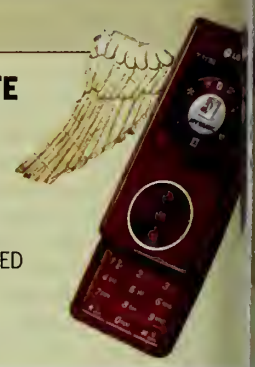
LOCKED, THROUGH VERIZON WIRELESS

$149

(two-year contract)

UNLOCKED, PURCHASED ONLINE

$290



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MARKETING

SILICONE GOES SUBTLE

Allergan's campaign relies on friendly persuasion

NEW TACK Allerg Web site provide ample infomatic warning women the potential risl

BY CHRISTOPHER PALMERI AND ARLENE WEINTRAUB

NOW THAT THE FDA HAS lifted a 14-year moratorium on silicone breast implants, Allergan Inc., which along with rival Mentor Corp. owns the lion's share of the global business, faces what seems like a monumental marketing challenge. It must find a way to persuade women to pay $5,000 for a surgery that only a few years ago many claimed was making them desperately ill. Allergan CEO David E.I. Pyott professes himself unfazed by the job at hand. "I don't really see it as a challenge," says the irrepressible Englishman. "I see it as an opportunity."

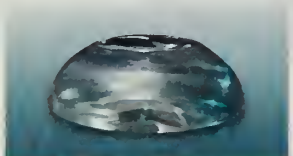
Allergan has lost no time revving up its marketing machine. Practically the moment the Food & Drug Administration gave the green light on Nov. 17, the Irvine (Calif.) company went live with an informational Web site for consumers. It features the oh-so-searchable address breastimplantstoday.com. Meanwhile, Pyott has been laying the groundwork for a public-relations blitz, flying to New York, for example, to powwow with women's magazine editors. He has been poaching marketers from companies with long experience selling to women, including Nestlé and Procter & Gamble Co. Next year, Allergan will launch a print advertising campaign.

Initially, says Pyott, "our objective is to destigmatize this product." He's the man to do it. Pyott helped turn Botox into a cultural phenomenon—by cozying up to doctors, advertising 24/7, and fighting liability claims in court. Wrinkle-erasing Botox treatments will generate $1 billion in revenues for Allergan this year.

Silicone implants represent another magnitude of controversy. By the early 1990s they had a dominant share of the market, but sales collapsed when the FDA responded to claims that the implants caused such autoimmune diseases as lupus and imposed a ban on using them for augmentation (reconstruction was still allowed). Thousands of product-liability lawsuits filed against silicone implant makers forced Dow Corning Corp. into bankruptcy and prompted big players such as 3M, Bristol-Myers Squibb, and Baxter International to exit the business.

New studies have quieted many critics, but regulators are forcing Allergan to warn women of the potential risks. The company's own studies found that about 13% of women suffer a painful hardening of breast tissue and that the implants rupture in fewer than 3% of subjects. Women who opt for silicone are required to read and sign a 30-page consent form.

How do you get around such concerns? Since consumer focus groups suggested that women do a lot of research into the surgery before committing, Allergan has posted links to positive studies from such institutions as the Mayo Clinic and the National Cancer Institute. Allergan also hired Joanne Gladfelter, a nurse, to answer questions from consumers on the site under a feature it calls Ask Nurse Joanne. "They do a good jo providing information in a low-key v says Deborah MacInnis, a professo marketing at the University of Sout California's Marshall School of Busi "They're not saying: 'Oh, God, you're g to look so sexy and beautiful.'"



THE STAT

44%

Projected share of breast implant procedures a year from now that will use silicone, up from 20% today.

Data: Merrill Lynch & Co.

NATURAL LOOK

PLAYING TO the informed consum Allergan's game plan. Hence the ta "You've never looked smarter" o Web site. While some might find borderline-tacky, Pyott points out most women who opt to have br augmentation surgery, a far more mon procedure than reconstruc tend to be well-educated. Beside argues, "in people's minds, the wa look and feel cannot only be visu can be cerebral as well."

That may be a stretch. But the com is betting that vanity will trump Since the halt on silicone implants, mentations—mostly saline impla are up to 10 times the previous lev about 300,000 operations a year, the American Society of Plastic Surg Analysts are expecting Allergan's plant business to increase 20%, to million, next year (largely because cone, which looks and feels much natural, costs twice as much as sa Allergan's stock has climbed 33% May, when approval began to seem l to $120. Many women remain s mish, but Wall Street is cheering. ■

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Q&A

BUT JIM, WHAT DO YOU REALLY THINK?

Mad-man Jim Cramer on hedge fund "predators," must-go CEOs, and more

HE'S ONE OF THE HOTTEST acts in cable news, mixing wild antics and stockpicking rants on his frenetic hour-long CNBC show, *Mad Money*. Jim Cramer sat still for an interview with *BusinessWeek* Editor-in-Chief Stephen J. Adler as part of the Captains of Industry series at the 92nd Street Y in Manhattan. He talked about his days as an extremely successful hedge fund manager, revealed the inspiration behind his on-air persona, and, of course, shared his investing insights. Some excerpts:

After working as a journalist and then graduating from law school, you spent some time at Goldman Sachs. Then you started a hedge fund, which is where you made most of your money, right?

I made a killing at the hedge fund.... I had a good 14-year run and quit in my best year, which I always wanted to do.... I had this epiphany kind of intervention done by my family and friends at Thanksgiving weekend at the end of 2000. They said you're worth a huge amount of money and you're just absolutely the most miserable, horrible person on earth who nobody can stand, and everyone is worried about it....

I went in the next day and I stood on the desk and I said: "I'm out of here. It's all yours.... I have caused tremendous misery and heartache for everybody who works here, so it's yours." Then I left. And I never went back.

Looking back on it, what do you see as the broader societal value of the kind of trading you were doing?

I think that a guy like me in a hedge fund creates nothing. We're not the least bit valuable. We're just total predators.

So now you're doing *Mad Money*, which is a huge success. Everybody wants to know: "Is that you?" How much do you have to psych yourself up to do what you do on that show?

I would say that the histrionics are acting.... One of my best partners at my hedge fund was Gene Hackman.... He has been instrumental in giving me the lessons that I need.... Certainly the writing is mine, and the lightning round is mine. But the idea of the pacing and the idea of who I am on the show—a lot of it is coached by Gene and Betsy Hackman.

Now it's time for the Captains of Ind lightning round. First, Sirius Sat Radio.

If Mel Karmazin does not merge XM, he will not make it. That com cannot stand alone.... Sirius Satell not going to have a good quarter. I d want to own that stock unless he cal and they get a merger.

Avon.

I have said that as long as Andrea is running the company, it will not g She's one of my top five CEOs who leave. Not a nice guy. I don't play o TV, either.

Which media stocks do you like leas

New York Times and Dow Jo They're really good brand names those are two companies I just can' They are too superior to everybody They're Holy Grail. You know, you be Holy Grail and be a business. I v rather invest in Harvard and Yale Dow Jones and the Times.

What's your outlook for the U.S. secu market in 2007?

I think it's going to be real good.. have incredibly low interest rates. F the big mortgage problem. The story for 2007 is that we just don't enough stock. Twenty-nine of 30 stocks in the Dow Jones average buybacks.

If you take a look at the moves yo in stocks now, it's because there ar no sellers.... Then layer o fact that the priva uity guys have raised $3 trilli Those force all fabulou the market.

Will the U. the dom economic p in the 21st ce or will we eclipsed by Chi

I think we' eclipsed by C The Chinese commu are just such great capitalists. Th just unbelievable capitalists masqu ing as communists, and they a competitive that I think in the en theirs to win. ■

BusinessWeek.com To watch a video of entire interview or r more, go to businessweek.com/extras.

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The Next Wave

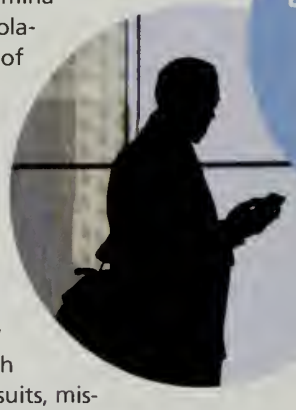
Helping Small to Mid-Size Privately Held Companies and Non-Profit Organizations Mitigate Management Liability Risk

While more than 95 percent of America's Top 1000 companies currently purchase directors and officers (D&O) coverage, estimates are that fewer than 10 percent of privately-held companies a non-profit organizations have made D&O coverage part of their overall risk-management strate

Since most small and mid-sized companies are not publicly held, their officers and directors may believe their organizations are immune from the risks associated with running a publicly held company. In reality, these organizations are often confronted with similar risks as their publicly traded counterparts. One lawsuit stemming from a breach of fiduciary duty, wrongful employment act or misappropriation of funds can wreak havoc on a mid-sized organization. And an act of employment crime can put a smaller organization out of business. As David Donovan, a vice president of Zurich, observes, "While the magnitude of claims filed against these entities is typically not as large in absolute terms as their publicly traded counterparts, the financial damage still can be great."

Small to mid-size companies and non-profit organizations risk exposure

Many of these same companies are exposed to a number of management liabilities beyond D&O exposure, and most are not properly mitigating against these potentially catastrophic risks. Privately held companies' potential liabilities fall into three major categories: (1) employment practices liability (EPL), including sexual harassment, discrimination, and wrongful termination; (2) patent and copyright violations, such as theft or disclosure of trade secrets, customer lists, and other intellectual property; and (3) financial operations liability, including claims arising from bankruptcy, insolvency, and business and investment valuation. Non-profit organizations also have EPL as a primary concern in managing day-to-day operations and grapple with such additional matters as donor lawsuits, misappropriation of funds, and excessive executive pay.



There are also a host of emerging issues that threaten to increase these liabilities. For instance, mergers and acquisitions can trigger a variety of EPL claims resulting from staffing reductions and relocations. In addition, merger and acquisition activity can trigger claims from minority shareholders alleging lack of true valuation of their ownership interest in the company. Courts are also increasingly recognizing insolvency as a cause of action against directors and officers, who are alleged have fraudulently or negligently extended the life of company, thereby eliminating the possibility of payme for goods and services.

Minimizing management liability risks

Such liabilities would be reason for concern in any ca but they are especially troublesome for privately held a non-profit entities, which tend to be far less protected against these risks than are larger organizations.

Fortunately, these small to mid-size entities can take steps to minimize these risks without spending inordina amounts of time or money. First is simply to recognize t like their larger counterparts, they too confront a varie potentially financially crippling risks. Second is to intelli gently survey the options, including D&O and EPL cove for indemnifying against these risks. And third is to est lish a formal risk management appro including the codifying of protec practices in hiring, personnel m agement, budget allocations, and financial management. An experienced insurer can add value in such arenas. For example, in claims man ment, a mis-timed suite ma result in a large jury award, while the exposure may be li ed by an insurer that understar the nuances of EPL litigation. Fin while regulations such as Sarbanes-O do not apply to privately held and non-profit orga zations, these organizations are well advised to inco rate aspects of the law's provisions into their operatic thus demonstrating their willingness and commitment adhere to such corporate governance practices at a tim when accountability for these is being scrutinized.

Small to mid-size entities can take steps to minimize these risks without spending inordinate amounts of time or money.

In the end, the benefits of these small steps can be s stantial. Notes Zurich's David Donovan: "Understandin and acting upon the available options can help streng the ability of both privately held firms and non-profit organizations to properly protect themselves against t potentially catastrophic risks of management liability."

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THE BIG PICTURE PAGE 50

THE BEST PLAYS PAGE 68

SMART STRATEGIES PAGE 88

WORKING THE NUMBERS PAGE 116

re's More Where This Came From

nline for extra interviews with our seers and interactive versions of the Fearless
ast and the Investment Outlook Scoreboard—at businessweek.com/extras.
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n to Executive Editor John A. Byrne interview Senior Editor Jeffrey M.
man about investing for the new year at businessweek.com/podcast.

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The Big Picture

Looking ahead to 2007, there's cause for optimism about markets and the economy

MARKETS PAGE 54

Most investment strategists remain high on stocks despite ominous signals from the bond market

BEST STOCK MARKET STRATEGIST PAGE 56

It came down to the wire, but A.G. Edwards & Sons' Stuart Freeman beat the other strategists in last year's stock market survey by a nose

THE STOCK MARKET PAGE 58

Wondering where the indexes are headed in 2007? The consensus of the 80 strategists in our annual survey is decidedly bullish

PUNDITS PAGE 60

Five pros with different perspectives and decades of experience handicap equities for next year

THE ECONOMY PAGE 64

According to the experts, housing won't trigger a recession, inflation will ease, and the dollar will decline, stabilizing the trade deficit

BEST ECONOMIC FORECASTER PAGE 66

Ken Maryland of ClearView Economics came closest to nailing the 2006 numbers in last year's survey

ECONOMIC SURVEY PAGE 68

The consensus of the 58 economists polled in our annual survey is for steady growth

TERRY ALLEN

LIBERTY
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2006

Where Optimism Reigns

Most investment strategists remain high on stocks, especially American ones. BY MARA DER HOVANESIAN

STOCK INVESTORS SAY IT'S the best of times, bond mavens insist it's the worst. The tale of two markets rallying simultaneously poses two conflicting scenarios: Will the economy fall into recession, as the recent bond market rally seems to suggest? Or is it destined for a rare soft landing, with profit and economic growth merely slowing to more sustainable levels, as the stock market is signaling?

U.S. corporations have been charging ahead for a long time now. The fourth quarter could mark the 19th consecutive quarter of double-digit profit gains among companies in the Standard & Poor's 500-stock index. As a percentage of gross domestic product, those profits are at a 40-year high. What's more, cash flow at S&P 500 companies is the largest in two decades. Bullish investors, expecting more of the same in 2007, have bid up stocks: The S&P 500 gained 12.9% in 2006 through Dec. 8, the NASDAQ Composite Index added 10.5%, and the Dow Jones industrials tacked on 14.8%. Meanwhile, stock market volatility has plunged to a 12-year low, indicating that investor sanguinity has reached historic proportions.

But signs of trouble are mounting. The housing slump could worsen, taking consumer spending down with it. A key manufacturing gauge turned negative in mid-December, potentially warning of recession. And the crisis in Iraq raises questions about oil supplies and geopolitical stability. "There are a relatively large number of potential problems on the horizon, any one of which could derail things," says Timothy L. Swanson, chief investment officer for some $30 billion in assets at the private client group of Cleveland bank National City Corp.

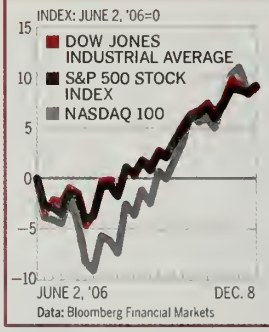
This isn't the first time the stock and bond markets have sent contradictory messages. Westport (Conn.) research and money management firm Birinyi Asso Inc. found 16 such instances since In 100% of the cases when both s and bonds hit 52-week highs, s were up six months later, with an age gain of 8%. Bonds have been h only 75% of the time, with an av increase of 4.1%.

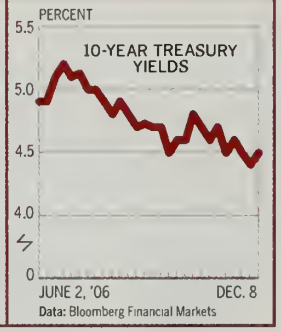
NOT THAT HISTORY IS destined to r itself. That the bond and stock ma are rallying reflects "the complex the financial world today, and un nately that's the difficulty investors says Birinyi President Laszlo Birir "So many of these new issues are on limited statistical observations."

There's no precedent for today's market, for example. When long Treasury bonds have yields lower those of short-term notes, as the now, it usually signals recession some bond watchers say the recent ing owes more to the insatiable des China, Japan, and other foreign n

WHO TO BELIEVE?

STOCK TRADERS SAY...	BOND TRADERS SAY...
Stocks are cheap	Housing market still scary
Profits will fall, but not off a cliff	Meltdown of economic growth will be global
Fed will lower rates because inflation is tame	Fed will lower rates because economy needs rescuing
Corporate coffers are flush with cash	Consumer spending will slow





est the U.S. dollars they collect from icans in trade. And foreigners, they nd to apportion their investments all bond maturities without regard e economic outlook. "They are in-ent to the realties of our economies. don't have anywhere else to go," ames Swanson, chief investment gist at MFS Investment Manage-in Boston and manager of the million MFS Diversified Income "I don't see this changing. The are being pushed down by too liquidity."

st stock market watchers are bank-the so-called liquidity argument. quick glance at our Fearless Fore-survey (page 58), and you'll see ptimism reigns. Despite the many say the bulls, the positives are too rous to ignore. Record cash flows ear will be used in 2007 to invest erations or to fund shareholder-ly activities such as stock buybacks vidend increases, both of which are ted to keep pace with those of the last few years. Merger mania (page 72) continues to underpin stocks. Valuations are still nowhere near their late-1990s bubble levels. And with interest rates still quite low by historical standards, stocks seem like the best game in town.

SLOWING GLOBAL GROWTH, meanwhile, should bode well for U.S. investments. In the last several years investors have flocked to everything from gold to emerging market shares. "We think that's shifting now," says Gary Thayer, chief economist at A.G. Edwards & Sons Inc. "Investors are looking a lot more favorably on U.S. financial assets in both stocks and bonds." Adds Marc D. Stern, chief investment officer of Bessemer Trust in New York, which has $46 billion under management: "Our theme is that risk is mispriced. People are putting money in places they wouldn't visit." Stern anticipates a pullback from high-yield bonds as well as some emerging-market stocks and bonds in 2007 and a flight to the relative quality of U.S. issues.

Which stocks to buy? George F. Foley, a portfolio manager for the Glenmede Large Cap Value and Core Value funds, is leaning heavily toward materials companies, particularly well-known names such as Alcoa, Alcan, and Phelps Dodge that he thinks can benefit from gains in efficiency. Merrill Lynch & Co. chief investment strategist Richard Bernstein favors high-quality tech companies, discount retailers, global defense companies, and multiline insurers. He also likes industrials and telecom shares as the demand for raw materials and expertise increases in a burgeoning global infrastructure.

Tech seems to be a common theme for 2007. John B. Cunningham, chief investment officer at J. & W. Seligman & Co. in New York, likes hardware specialists such as computer, hard drive, and memory makers as consumer demand for electronics and capital spending by big corporations continue at a healthy clip. "The fundamentals are still very solid," he says. "We think tech can outperform the

broader market." He also recommends telecom equipment makers as regional phone operators expand their systems to compete with cable operators.

DON'T FORGET FINANCIALS, says Edward Yardeni, chief investment strategist of Oak Associates Ltd. He says the stocks of investment banks and asset managers are good ways to bet on merger mania and retiring baby boomers. And although energy has been one of the best-performing sectors in the S&P for the last three years, plenty of opportunities remain, he says. There's still momentum in the drilling, equipment, and services companies. "Look around," says Yardeni. "We have a capital-spending boom going on."

Internationally focused investors should expect global economic growth to slow but not to crash, and opportunities to persist. Developed markets seem especially cheap, trading at an average of 12.4 times expected 2007 earnings, compared with a 10-year average of 18.7, according to MFS. "There's still massive liquidity looking for a home, and valuations are still attractive in a number of markets," agrees Simon Davis, co-chief investment officer based in London for Putnam Investments. Davis says that while many China-based companies have been bid too high, it's smart to look at suppliers to an economy that continues to grow 10% a year. He favors mining and natural resources outfits in Australia, including Zinifex, BHP Billiton, and Rio Tinto, which is dual headquartered in Melbourne and London.

The likely losers? Bessemer's Stern cautions investors to stay away from housing-related stocks such as homebuilders, construction companies, and savings and loans. Although it may be tempting to think that there are bargains among them, he says "the profits they've posted in the last couple of years exaggerate their long-term earnings potential." Profit margins at small regional banks will keep being squeezed by higher short-term interest rates. And the pressure on companies to use their free cash to buy back shares and issue dividends rather than pay down debt doesn't bode well for high-grade corporate bonds.

The biggest risk to investors: inattention. Yardeni, who predicted the strong stock market of 2006, says the S&P could reach 1600 by midyear, a 13% gain, which will get investors worried about higher interest rates. And the ensuing sell-off, he says, will offer opportunity once again. ■

BEST STOCK MARKET STRATEGIST

The Bull Who Hit the Bull's-Eye

BY BREMEN LEAK

The contest among the top equity strategists in this year's Fearless Forecast stock market survey couldn't have been closer. Stuart T. Freeman of A.G. Edwards & Sons and Charles Mayer of Pioneer Investments Inc. hit yearend targets with astounding accuracy. But when we called the contest on Dec. 6, Freeman got just a bit closer to the bull's-eye. He missed the Dow Jones industrial average's level of 12,309 by a mere 1.7% and erred by less than 1% on both the Standard & Poor's 500-stock index and NASDAQ Composite (table). Mayer was right behind him. Jim Cramer of CNBC and TheStreet.com finished third.

FREEMAN Dow 13,700 by yearend

In fact, more than half of the 76 forecasters we polled a year ago came remarkably close: On average, their forecasts on the Dow, the S&P, and the NASDAQ were within 5 percentage points of the actual closes. In the end, Freeman's calculated optimism gave him the edge. "Our expectation was that we'd have a strong earnings year and the economy would move forward at a better-than-average pace," says the 46-year-old chief equity strategist of the St. Louis financial services firm. The biggest surprise? The continued strength of small-cap stocks.

Freeman, who earned both a bachelor's in finance and an MBA from Washington University in St. Louis, credits a favorite professor, John Bowyer, for teaching him to analyze the stock market. Since joining A.G. Edwards as a health-care analyst in 1983, Freeman has developed a set of models with 200 variables that go back 30 years, including the average duration of unemployment and a measure of after-tax corporate profits. With these, he can simulate the economy and determine which industries will do best under the various conditions he forecasts.

Freeman predicts a yearend Dow finish o 13,700, up 11% from its close on Dec. 8, and 10% and 8% hikes in the S&P and NASDAQ, respectively, over the course of 2007—more bullish than Mayer, who's executive vice-president and director of portfolio management at Boston's Pioneer. Accordin to Freeman's crystal ball, economic growth will slow—and with it, earnings growth. But large-cap stocks will appreciate as they hav for the past few months. "There are stocks hitting new highs," he says, "but they are much cheaper than they were when they were at old highs in 1999 and 2000 because earnings have grown so dramatically." ■

THE WINNING PREDICTION FOR 2006

COMPANY	DOW JONES INDUSTRIAL AVERAGE	STANDARD & POOR'S 500-STOCK INDEX	NASDAQ COMPOSITE INDEX	RUSSELL 2000 INDEX**
FREEMAN'S FORECAST	12,100	1,400	2,470	730
ACTUAL LEVELS*	12,309	1,413	2,446	796

*Dec. 6 **Not considered for contest purposes

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THE *BUSINESSWEEK* MARKET SURVEY

NAME/FIRM	DOW JONES INDUS. AVG. MIDYEAR	DOW JONES INDUS. AVG. YEAR END	S&P 500 YEAR END	NASDAQ COMPOSITE YEAR END	RUSSELL 2000 YEAR END	ASSET ALLOCATION* U.S. STOCKS	INTL. STOCKS	U.S. BONDS	CASH	FAVORITE STOCK SECTOR	FAVORITE STOCK
BERNIE SCHAEFFER Schaeffer's Investment Research	13250	**14400**	1580	2600	975	60	0	10	20	Cons. durables	Lennar
JOHN REGAN Americal Investment Strategies	13258	**14246**	1619	2885	938	65	20	10	5	Energy	MasterCard
JOHN KATTAR Eastern Investment Advisors	12600	**14200**	1550	3000	870	35	20	20	25	Energy	James River Coal
RALPH ACAMPORA Knight Equity Markets	12300	**14200**	1550	3000	875					Services	Globecomm Systems
ELAINE GARZARELLI Garzarelli Capital		**14200**	1640	2905	875	90	10	0	0	Technology	Lehman Brothers
ED YARDENI Oak Associates	12450	**14035**	1620	2806	910	65	25	10	0	Financials	Goldman Sachs
CHARLIE CRANE Scotsman Capital Management	13350	**14000**	1615	2875	850	95	0	0	5	Ind. cyclicals	Transocean
WARREN BAGATELLE Loeb Partners	13100	**14000**	1600	2800	910	65	0	15	10	Health care	
ROBERT FROEHLICH DWS Scudder	13000	**14000**	1600	2800	875	15	50	5	0	Energy	China Mobile
CHARLES REINHARD Lehman Brothers Asset Management		**14000**	1600	2800	860	30	22	17	8	Cons. staples	Chattem
ROBERT BAUR Principal Global Investors	13000	**13850**	1525	2850	900	50	20	15	10	Technology	
MARC ZABICKI H&R Block Financial Advisors		**13800**	1570	2800	880	45	10	20	20	Technology	
BRIAN STINE Allegiant Asset Management	13100	**13700**	1560	2700	880	50	15	35	0	Energy	
STUART FREEMAN A.G. Edwards & Sons	13450	**13700**	1550	2630	830	52	8	35	5	Cons. staples	Walgreen
DAVID KATZ Matrix Asset Advisors	12901	**13653**	1558	2838	872	70	5	15	10	Technology	MedImmune
DAVID GOERZ HighMark Capital Management	12900	**13650**	1550	2830	880	54	12	17	15	Technology	Intel
LARRY SMITH Third Wave Global Investors	13000	**13600**	1550	2850	900	55	20	10	5		
PRICE HEADLEY BigTrends.com	12800	**13600**	1550	2900	890	60	20	20	0	Technology	Intl. Securities Exhange
CHRIS SHELDON Mellon Private Wealth Management	12950	**13560**	1520	2615	840	36	12	40	0	Technology	
KEITH WIRTZ Fifth Third Asset Management	12945	**13552**	1601	2781	854	56	10	26	3	Technology	Microsoft
LINCOLN ANDERSON LPL Financial Services	13000	**13500**	1590	2900	860	75	5	15	5	Technology	
ROBERT MORRIS Lord Abbett	13070	**13500**	1550	2600						Ind. cyclicals	Corning
JASON TRENNERT Strategas Research Partners	12400	**13500**	1530	2850	900	60	15	20	5	Technology	L-3 Communications
TIM SWANSON National City Private Client Group	12900	**13500**	1525	2675	855	50	13	32	5	Ind. cyclicals	Joy Global
CLARE ZEMPEL Zempel Strategic	12875	**13500**	1550	2700	875	60	20	10	10	Health care	Pfizer
JIM CRAMER CNBC/TheStreet.com	13000	**13500**	1550	2800	900	70	15	0	5	Financials	Marvell Tech Group
JAMES WONG Payden & Rygel	12600	**13500**	1540	3000	860	25	35	15	10	Technology	América Móvil
CHRIS CONKEY Evergreen Investments	12450	**13500**	1550	2450	840	50	15	20	5	Health care	Apollo Group
TOBIN SMITH ChangeWave Research	12876	**13488**	1550	2750	900	35	25	20	10	Technology	Apple
LEO GROHOWSKI U.S. Trust	12800	**13400**	1500	2675	850	31	14	27	5	Energy	
JOHN CLARKE H.C. Wainwright	12658	**13220**	1535	2700	890	45	25	20	10	Financials	Home Solutions of Amer.
ARTHUR HOGAN Jefferies	12850	**13200**	1533	2670	930	55	10	15	10		
Average											

We polled 80 strategists for their 2007 predictions, and many think tech stocks will be on top.

BY SONAL RUPANI, ANNE TERGESEN, AND BREMEN LEAK

CALL IT A 7% YEAR. That's the return the 80 strategists we polled expect in 2007 for the Dow Jones industrial average and the Standard & Poor's 500-stock index. Our prognosticators overwhelmingly think technology will be the best-performing sector next year, but still come up with a forecast of only a 9% gain in the tech-heavy NASDAQ Composite. They expect the Russell 2000, an index of small-cap stocks, to lag, with just a 6% return. Strategists are listed according to their yearend Dow forecasts, from the most bullish to the

HUGH JOHNSON [illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	Cons. staples	[illegible]
JOHN CLARKE H.C. Wainwright	12688	**13220**	1535	2700	890	45	25	20	10	Financials	Home Solutions of Amer.
ARTHUR HOGAN Jefferies	12850	**13200**	1533	2670	830	65	10	15	10	Energy	Las Vegas Sands
GEORGE JACOBSEN Trevor Stewart Burton & Jacobsen	13000	**13200**	1550	2750	900	70	10	15	5	Technology	Apollo Group
JOHN ROBERTS Hilliard Lyons	12800	**13200**	1500	2700	830	50	15	30	5	Technology	Flextronics
ROBERT STOVALL Wood Asset Management	13306	**13182**	1514	2627		40	25	15	8	Technology	Pitney Bowes
SAM STOVALL Standard & Poor's	12740	**13180**	1500			40	20	25	15	Ind. cyclicals	Matsushita Electric Indus.
MARK ELENOWITZ TriPoint Capital Advisors	13540	**13176**	1490	2664	882	45	25	15	12	Health care	NBTY
ROGER IBBOTSON Yale School of Management/Morningstar	12717	**13117**	1502	2664	820	31	16	31	9		
WILLIAM GREINER UMB Asset Management	13750	**13100**	1525	2600	860	65	10	25	0	Technology	Intel
ALLAN RONESS ASR Corporate Consultants	12500	**13100**	1465	2750	875	70	20	0	5	Energy	Pride International
BENJAMIN PACE Deutsche Bank Private Wealth Management	12650	**13100**	1500	2600	830	40	17	23	2	Technology	Monsanto
HARVEY HIRSCHHORN Bank of America	12800	**13100**	1520	2720	845	53	11	31	1	Technology	
RICHARD SICHEL The Philadelphia Trust Co.	13345	**13078**	1463	2569		70	0	30	0	Technology	Harris
GARY TAPP SunTrust Robinson Humphrey	12492	**13073**	1510	2649	847	48	24	18	5	Technology	L-3 Communications
BARRY HYMAN EKN Financial Services	12700	**13050**	1475	2750	860	50	10	20	15	Technology	
CHARLES MAYER Pioneer Investments	12250	**13025**	1490	2610	820	60	15	25	0	Financials	
VINCENT GALLAGHER Needham Funds	12800	**13000**	1500	2650	870	60	0	0	20	Services	Advisory Board
ASHER PLAUT Brill Securities	12500	**13000**	1550	2600	925	65	15	10	10	Health care	IRIS International
MARK JORDAHL FAF Advisors	12650	**13000**	1530	2700	850	44	14	33	7	Technology	
MIKE RYAN UBS	12600	**13000**	1500	2575						Health care	
DORSEY FARR French Wolf & Farr	12000	**12960**	1440	2340	755	20	30	15	5	Cons. staples	
IVAN GEFEN vFinance Investments	12730	**12950**	1487	2662	850	30	20	15	15	Technology	
JOSEPH BATTIPAGLIA Ryan Beck	11300	**12900**	1470	2600		55	10	35	0	Health care	Microsoft
JEFFREY KNIGHT Putnam Investments	12400	**12900**	1510	2675	840	25	20	15	10	Energy	PICO Holdings
WENDELL PERKINS Johnson Asset Management	12140	**12810**	1440	2490	800	35	40	10	10	Health care	Quest Diagnostics
ABHIJIT CHAKRABORTTI JPMorgan		**12800**	1440	2500	810	30	30	20	15	Cons. staples	Altria Group
TOBIAS LEVKOVICH Citigroup		**12750**	1400		800					Technology	General Electric
PETER TRAPP Bifrost Partners	12100	**12750**	1450	2530	835	30	30	20	20	Technology	NutraCea
DANIEL DEKTAR Smith Breeden Associates	12470	**12710**	1460	2481	800	15	30	10	20		
BRUCE BITTLES Robert W. Baird	12500	**12700**	1460	2540	820	45	10	40	5	Utilities	
TOM McMANUS Banc of America Securities	12400	**12700**	1465	2550	720	55	0	20	25	Cons. staples	Phillips-Van Heusen
ROGER DeBARD iGlobal Capital	12200	**12628**	1455	2536	808	35	5	10	40	Technology	AT&T
DOUG BERMINGHAM Jesup & Lamont	12810	**12500**	1475	2560	795	50	15	25	10	Cons. durables	AltiGen Communications
JEFF TYLER American Century Investments	12000	**12200**	1400	2425	750	50	12	35	3	Health Care	
LAWRENCE McMILLAN McMillan Analysis	12800	**12000**	1360	2390	760	25	15	35	0	Energy	Whole Foods Market
C. KIM GOODWIN Credit Suisse	12675	**11973**	1344	2550	750	20	35	25	0	Cons. staples	Avis Budget Group
DAVID JOY RiverSource Investments	11000	**11600**	1350	2420	750	25	35	20	20	Energy	
RICHARD DRIEHAUS Driehaus Capital Management	11500	**11600**	1330	2300	745	45	30	10	10	Health care	Daktronics
SUBODH KUMAR Subodh Kumar & Associates	11200	**11175**	1275	2100	685	35	21	20	12	Health care	
VINNY CATALANO Blue Marble Research	10600	**11000**	1260	2020	675	40	25	5	25	Cons. staples	Consumer Staples ETF
MICHAEL PAINCHAUD Market Profile Theorems	11300	**10200**	1094	1767	525	25	5	20	35	Health care	ImClone Systems
RICHARD BERNSTEIN Merrill Lynch			1488			40	10	30	20	Cons. staples	
CONSENSUS	12604	**13155**	1501	2647	838	49	17	19	9		

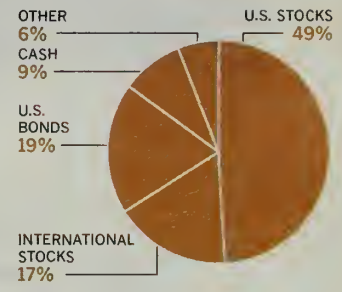
* Asset allocations do not total to 100 in some cases because of allocations in other categories, such as gold, REITs, hedge funds, and non-U.S. bonds

CHART BY LAUREL DAUNIS-ALLEN/BW

Average	[illegible]	[illegible]	[illegible]
S&P 500	1640	1094	1501
NASDAQ Composite Index	3000	1767	2647
Russell 2000	975	525	838

Data: Credit *TK*

CONSENSUS ASSET ALLOCATIONS



MOST POPULAR SECTORS

	NUMBER OF RECOMMENDATIONS
TECHNOLOGY	28
HEALTH CARE	14
ENERGY	11
CONSUMER STAPLES	9
INDUSTRIAL CYCLICALS	5

MOST POPULAR STOCKS

	NUMBER OF RECOMMENDATIONS
APOLLO GROUP	2
CORNING	2
INTEL	2
L-3 COMMUNICATIONS	2
MICROSOFT	2

Where to Go for Growth in '07

Five pros with different perspectives and decades of experience handicap stocks. BY DAVID HENRY

SOMETIMES THE BEST WAY to divine where a market is headed is to listen to individual voices amid the roar of the investing crowd. But whose voices? We picked five individuals who have made their way through bull runs and bear attacks for decades. Our panel includes people with international perspectives and those who collectively work alongside a wide range of professional investors: One works for a hedge fund, another for a British asset manager, two for U.S. money managers, and the fifth for a research shop.

Their consensus: Investors should do fine with U.S. stocks, but to do better they'll have to pick the right companies and wade into other markets. Not surprisingly, all have misgivings and caveats, too.

Jason Trennert

"YOU'RE GOING TO have a pretty good market in 2007," says Jason D. Trennert, chief strategist at Strategas Research Partners, who has boosted his credibility lately with prescient calls. He warned early this year that emerging-market stocks were too high; they plunged in May. And over the past two years, when others predicted slowing U.S. earnings growth, Trennert remained confident. Good call: Earnings per share for companies in the Standard & Poor's 500-stock index rose at double-digit rates for a record 18 quarters in a row through September.

Now, Trennert expects the pace to decelerate alongside the overall economy. He predicts that earnings for S&P 500 companies will rise about 6% in 2007, vs. about 15% in 2006. But he also expects softening in the economy to prompt the Federal Reserve to ease short-term interest rates in May, which would probably make stocks more attractive. In fact, Trennert expects investors to be willing to pay up for stocks. Right now they trade at an average of about 16 times earnings; he sees that multiple rising to 17. Overall, he says, the S&P will be at 1,530 by yearend 2007, up nearly 9%.

JASON TRENNERT

TITLE Managing Partner & Chief Investment Strategist

FIRM Strategas Research Partners

OUTLOOK Bullish on U.S. stocks

WATCHING FOR Fed to cut interest rates in May

"It could be higher, if anything," he

Trennert concedes that he's predic a Goldilocks scenario in which econ growth slows just enough to let the ease but not so much as to kill earn growth. He'll be wrong if things turn too hot or too cold.

What to buy? Megacap U.S. st which he calls "the cheapest asset in the world." Especially appealing big techs with strong balance sheets products to sell to corporations ma capital investments. Microsoft Cor his prime example. Look also to field-services companies, he says. if economic growth slows, t benefit as the world make for years of underinvestme oil and gas exploration. He Schlumberger Ltd., a giant ir business. And "as a flier" sen to lower interest rates, Tre recommends homebuilder Brothers Inc. Builder stocks already been marked down for the housing slump. "Ev the economy slows, [Toll's] l end customer is going to l good shape," he says.

Michelle Clayman

WITH $6 BILLION under agement and 20 years of ex ence running money for pe funds and high-net-worth viduals, New Amsterdam ners founder Michelle R. Cla doesn't mind saying that she believes the economy will f a Goldilocks scenario. It's ing to a steady 2% to 2.5% for next year, she says, whic

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be just right for buying stocks at current prices. "We've seen the worst of inflation, and at the same time, you have decent productivity growth and [profit] margin expansion." Oil prices are moderating, and companies are operating more efficiently thanks to info tech, outsourcing opportunities, and slower hikes in labor costs.

Clayman's bullishness is also based on stock valuations being reasonable. The last time the S&P 500 d around its recent 1,410 was six ago, when earnings from compa- n the index were only about 60% of 's level. With so much more profit ng stocks now, Clayman says, "the S market is fairly valued to undervalc She doesn't see the economy slowg nough to undermine the earnings n. And while she's wary of executives ning less vigilant about keeping up earnings momentum, she doubts ill happen. "Companies continue to y good at cutting costs and improvg e way they run their businesses."

his point in the economic cycle, she don't bother with stocks of compawhose fortunes rise when the econ s picking up speed—they've already heir run. Instead, look for com s with more specific stories. For ple, Clayman likes Merrill Lynch as a play on the boom in leverbuyouts and fees from deal g. Merrill is also harvesting from consolidating acquisi t has made over the years. ock "is relatively cheap," ys. It trades around 13 next year's earnings, ared with a market earnings ratio of 16.

S also likes retailer Best Buy Co. for its angle on consumer electronics. Sales are getting a boost from demand for flat-screen TVs and videogame platform upgrades. The hitch is that the stock recently traded at around 17 times next year's earnings—not cheap as retailers go.

A stock that's benefiting from the pursuit of productivity in manufacturing is ANSYS Inc. It makes simulation software to use with computer-aided designs, allowing companies to test virtual prototypes quickly. ANSYS' p-e is high at about 24, but profits are increasing by over 20% annually, so paying up is warranted, says Clayman. And more than 50% of the sales of the Canonsburg (Pa.) company come from abroad, which she says is a big plus: "Some non-U.S. economies will grow faster than the U.S. next year."

David Herro

THE TWO BIG Oakmark-brand international mutual funds that David G. Herro manages at Chicago's Harris Associates have done very well in the past five years: Oakmark Small-Cap International is up 25% annualized, and Oakmark International is up 17%. But Herro warns that those performances aren't sustainable. "It is not natural. The natural rate [for international stocks] is, like, 12% to 13%."

Why isn't Herro, who now manages $21 billion, feeling more like a confident victor? Herro, who describes himself as "neutral," says some of the recent gains result merely from currency translations after the decline of the dollar since March. He believes the dollar is unrealistically low now, and international stocks generally "are not cheap."

But he is finding values in blue-chip global companies, which he figures are trading for about 10 times their cash flow. That's a good level for financially strong companies with high returns, and it's down from 15 a few years ago. Examples include Switzerland's Nestlé, Britain's Cadbury Schweppes and GlaxoSmithKline, and Germany's DaimlerChrysler. Glaxo, the big pharmaceutical company, generates 30% returns on equity, boasts 30% operating margins, and has a dividend yield of 3.4%, he notes. Herro also likes drugmakers Novartis of Switzerland and Takeda Pharmaceutical of Japan. Those stocks have been hurt by the prospect of government restrictions, he says, but "all of the negatives are in the prices. People are ignoring the long-term positives" of aging populations and unhealthy lifestyles.

Nestlé and Cadbury, makers of candies and beverages, are dependable businesses that generate steady cash flow. Their stocks would hold up well even if there's financial instability elsewhere, Herro says. He likes DaimlerChrysler as a turnaround story. That stock has suf-

DAVID HERRO

TITLE Chief Investment Officer, International Equity

FIRM Harris Associates

OUTLOOK Neutral on international stocks

WARY OF Unwinding of LBO and hedge fund booms

fered because its Detroit-based Chrysler lines are tainted by the decline of the U.S. auto industry. The penalty won't last, he argues, because Chrysler accounts for only about one-fifth of the company's value.

Some of Herro's recent wins have come from takeover premiums paid by leveraged buyout firms. But he's wary of how long that will last. LBO firms and hedge funds, he notes, have attracted lots of money, leveraged up, and bid up asset prices. At some point returns will slide, investors will flee, and the funds will have to unwind the leverage and sell their stakes. "The money coming out of these vehicles may strain the system," says Herro. "That's something to be cautious about."

Byron Wien

WHEN THE VETERAN strategist calls himself "neutral" on U.S. stocks, it doesn't mean Byron Wien foresees a flat year. He expects the S&P to gain something like 5% to 10%, in line with earnings growth. But Wien doesn't find that prospect satisfying when set against the risk that investors are overconfident. "There's too much complacency, and that makes me apprehensive," he says. "The problem is that nobody is concerned about terrorism, our failure in Iraq, that housing will turn out worse, or that the trade deficit is inexorable and that therefore the dollar is doomed in the long run." But he concedes that the market is up this year, "and I can't ignore that."

Wien, 73, says he's looking for opportunities that go against the grain for Pequot Capital Management, the $7 billion hedge fund firm he joined last year after a successful 20-year run as a market sage at Morgan Stanley. He won't disclose his specific picks but says: "I like commodities generally. The softer commodities—potash, corn, wheat, and soybeans—will do well." Why? Economic growth around the world is raising living standards, and that means bigger meals with more grain-fed beef and chicken. And he's watching for plays in oil, which, contrary to conventional wisdom, he predicts will go to $80 a barrel. Wien is also "warming up to health care." There's pessimism about those stocks because of concerns that Democrats in Washington may somehow impede earnings prospects. Wien, however, expects to see the sector invigorated by advances against Alzheimer's, heart disease, and cancer.

The best bets may well be overseas, in major industrialized markets. "I think Japan will surprise us," Wien says. Japanese stocks generally were the worst performers in 2006, so their prices could spurt to catch up. "They're operating a lot of facilities in China, and they're a clear beneficiary of growth in Asia," he says.

BYRON WIEN

TITLE Chief Investment Strategist

FIRM Pequot Capital Management

OUTLOOK Neutral on U.S. stocks

WATCHING FOR Rising stocks in Japan

MICHAEL HUGHES

TITLE Chief Investment Officer

FIRM Baring Asset Management

OUTLOOK Bullish on Asia

WARY OF A destabilizing collapse in credit mark

Michael Hughes

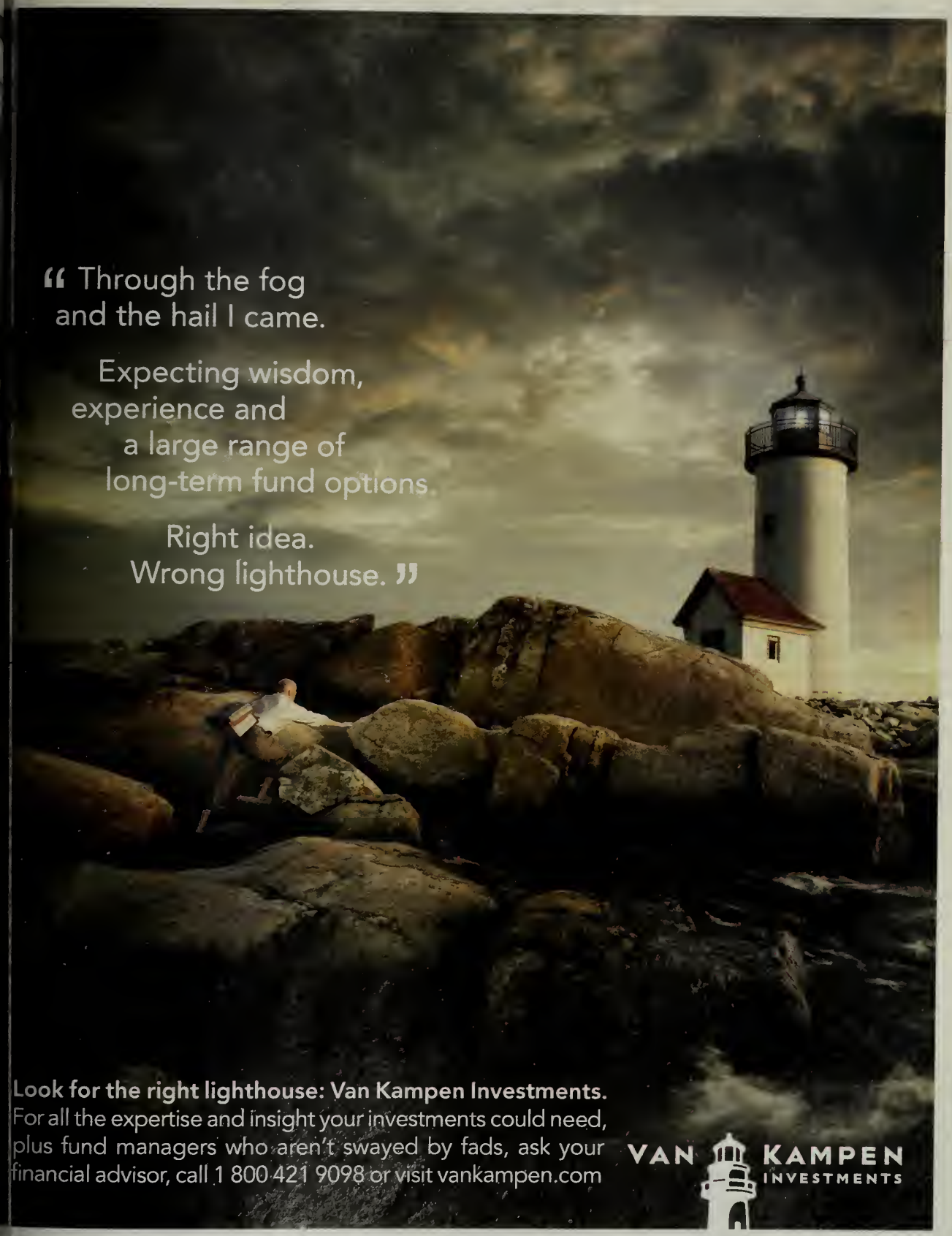
ONE OF THE MOST respected market watchers in the City of London, Michael Hughes is chief investment officer at Baring Asset Management, which manages $39 billion in institutional and mutual funds. He has seen a lot of ups and downs over his 33-year career. Nowadays he's generally positive about the global economic outlook. But the bigger gains, says Hughes, won't be had in Western countries. And he worries about easy credit bidding up asset prices around the world.

Hughes, 55, says the world economy is in the midst of a boom, driven by falling prices for goods and labor, that's capable of running 5 to 10 more years. The favorable environment has been created by the industrialization of China and India and the greater mobility of capital. Economic leadership next year will "shift from the West, and partic the U.S., to Asia, Eastern Europe parts of Latin America," he says. (stocks will remain good bets. He favors Japanese companies, espe small caps, which are less exposed strong yen because they tend to e less. Korea, Thailand, and Vietnan do well, too, says Hughes, thoug best way to play those markets is th diversified equity and bond funds.

Commodities continue to be a goc he adds, given the long run of grow foresees. It's best to use vehicles tha balanced exposure to oil, precious m and industrial metals, he adds, rathe funds focused on just oil or gold.

What could go wrong? The which, Hughes thinks is fairly v could nonetheless take a sharp fal trigger retaliatory action from E or Japan, ending the current peri economic stability. Hughes also that with borrowing for everything corporate buyouts to houses runni high levels, the risk of a credit m accident that could destabilize the economy is high. That's because th is using a lot of leverage, and many classes around the globe are expe As a result, the risk of asset price def is high, he says. ■

–With Stanley Reed in L



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Drawing a Bead On the Future

We put four key economic questions to 58 experts for a sneak peak at the year to come. BY JAMES C. COOPER

1 Will the housing recessio sink the economy?

SMART INVESTORS ALWAYS ASK PLENTY OF QUESTIONS. GETTING the right answers is the hard part, especially answers about the future of the economy—and the windshifts that can make or break your portfolio. *BusinessWeek* offers some help on what we think are the four key questions that will play the biggest roles in shaping the investment climate in 2007.

We gathered 58 experts and their best estimates for our annual outlook survey (page 68). The overview looks like this: On average, the economists see an investor-friendly economy, with growth cooling to 2.6% from the end of 2006 to the end of 2007. That's a notch slower than the 3.1% pace expected for 2006, but they project a slight pickup in the pace as the year progresses. The slowdown will cause the unemployment rate to drift up—though not by much—from 4.5% to 4.8%. The slump in home construction is expected to end by midyear, yet by the end of the year, home prices are still projected to dip nationally by an average of 1.7%.

The best news for investors is that cooler growth would allow core inflation, which excludes energy and food, to moderate. The consumer price index is projected to rise 2.5%, while the core CPI is pegged to go down a notch, to 2.4%. A tamer look for inflation will give the Federal Reserve leeway to trim its target interest rate to just below 5%, from 5.25% at the end of 2006. Fed policy easing will restore a flatter yield curve, with the return on a 10-year Treasury note also expected to drift up by the end of the year to just under 5%. Profits will continue to grow but at a slower single-digit pace, compared with high double-digits in 2006.

Overall, not a bad outlook. Of course, no consensus forecast is ever a sure thing. So let's take a look at those nagging questions.

NOT LIKELY. Although no ho downturn of this magnitude has occurred outside of an economy recession, this housing slump is un The market simply fell under its weight of speculation, overbuilding soaring prices, all without the usual from punishingly high mortgage tight credit, or rising unemployme a result, the housing recession ha mained confined to the housing sec

That said, the economy would grown more than a percentage poin er without the direct effects of cutba home construction in both the thir fourth quarters of 2006. And the will continue into early 2007. "I sales are bottoming out in the f quarter, but the inventory overha quite heavy and residential constr will fall further," says David F. Seid the National Association of Home l ers. However, Seiders and other e mists believe the drag will ease in th half, and builders will begin bre ground again by late spring.

s the indirect effects, centered on g home prices, that generate the es. Most all economists expect s in the rest of the economy, es- ly in consumer spending, will be idable. Slower spending in 2006 eady forcing businesses to adjust nventories, which is showing up as weakness in manufacturing—and eed to cut production will extend arly 2007.

ese second-round effects should be geable. "The wealth effect of hous- quity on consumer spending will t, but not by more than 0.5% off mer spending growth," says David eah of the National Association of rs. Growth in jobs and incomes, with stock market gains, will cush- e drop in home equity.

s the Fed's next move a ate cut or a hike?

TWO-THIRDS OF the economists expect a rate cut at some point, while only nine of our 58 pan- look for further hikes. But don't any Fed action until well into the The odds of an eventual Fed eas- creased in late 2006 as evidence tinued slow growth emerged. "It be crazy for the Fed to further il the expansion by raising rates teeth of an inventory and housing tion," says David Kelly at Putnam ments. As the housing slump, the y slowdown, and moderation in mer spending filter through the my, pressures on inflation are sure e. "Why should interest rates rise if there is more slack and inflation becomes less of a problem?" asks Jan Hatzius at Goldman Sachs Group Inc.

So far, core inflation, which excludes energy and food, has shown few signs of backing down. The Fed's preferred measure stood at 2.4% in October, above its informal 1% to 2% comfort zone. What separates the handful of hikers from the cutters is their expectation that the economy will not slow enough to allow the inflation rate to drift lower. "We expect consumer spending to remain strong and believe that overall growth will pick up as the drag from housing and autos fades," says Dean Maki, at Barclays Capital.

In fact, Fed officials have continued to talk tough about the pressures on prices, especially those from rising labor costs generated by tight labor markets. However, the job markets and inflation always respond to an economic slowdown with a lag. "The Fed's current focus on inflation risks should fade once some slack opens up in the domestic economy," says Kevin Logan at Dresdner Kleinwort Ltd. Indeed, most economists expect the jobless rate to begin edging up by early 2007.

3 Will the profit boom turn to bust?

A PROFIT SLOWdown is inevitable, as top-line revenue growth slows and profit margins narrow. Profit growth will most likely slide down to single digits, but don't expect a crash. "All the restructuring and cost-saving over the past 20 years is paying off for Corporate America," says David Berson at Fannie Mae. Corporate profitability in the third quarter of 2006, measured as profits per unit of real GDP, was the highest in four decades.

Productivity has not fallen off as sharply as it has in past business cycles, and labor costs are not burdensome. In fact, unit labor costs may even be overstated, says Stephen Gallagher at Société Générale. He notes that labor compensation is increasingly tied to profit performance, a trend that eases the traditional margin squeeze. "Profitability usually peaks several years before the economy goes into a recession," says Dana Johnson at Comerica Bank. That means there is a lot of room for profit growth to slow before the economy is in danger.

Profits will support healthy, if slower, growth in business investment in new equipment and facilities. With margins still high and firms sitting on huge cash reserves, "capital spending should still be one of the brighter spots," says Nariman Behravesh at Global Insight Inc.

4 How will the global outlook play into U.S. prospects?

EXPECT TWO key trends, both good for the U.S. economy: The dollar will slide lower, helping to boost exports and profits returned to the U.S. from overseas operations. And the trade deficit will finally begin to stabilize, albeit at a still-high level and with further widening in the gap with China.

"The rebalancing of the global trade position has begun," says Robert Shrouds at DuPont. Economies in Europe, Japan, and throughout Asia are strengthening as U.S. growth is slowing. What's dif-

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Sun microsystems share

ferent now is that economies overseas are growing from within, fueled more by strong domestic demand and less by exports, especially to the U.S. "We're no longer the buyer of last resort, and the rest of the world appears to be decoupling from U.S. growth," says Diane C. Swonk at Mesirow Financial Holdings Inc. That uncoupling will give the global upturn legs, and assure that the current boom in U.S. exports can be sustained, especially as the dollar heads lower.

The downward forces acting on the greenback will persist due to better growth prospects abroad and narrower differences in interest rates, as overseas central banks continue to tighten policy while the Fed is on hold. The European Central Bank is still raising rates, and the Bank of Japan is about to begin. These trends favor foreign investments relative to those in the U.S. Plus, "China has embarked on a gradual process of reweighting its foreign exchange reserves in favor of the Japanese yen, the euro, and other nondollar currencies," says Donald Straszheim at Roth Capital I ners. That increases the Chinese yu value vs. the dollar, but lowers it in a where China wants to sell its goods.

Could the dollar crash? "A crisis o to be avoided as long as growth an terest-rate differentials are not too ishing," says Joshua Shapiro at MFR The biggest risk to the dollar would U.S. recession, but if the economist our panel have the right answers t these key questions, that's nothing investors to fear. ■

BEST ECONOMIC FORECASTER

He Nailed 2006—Then Went Fishing

MAYLAND at ClearView Economics' headquarters

Heading into 2006, most economists saw strong profit growth, increased hiring, and rebuilding after Hurricane Katrina driving the economy. Ken Mayland looked back—at prior periods when the Federal Reserve had raised interest rates—and saw a slowdown on the horizon. Mayland's bet that history would repeat itself made him *BusinessWeek*'s most accurate economic forecaster for 2006, beating out Ian Shepherdson of High Frequency Economics by a slim margin.

Because Mayland runs his own economic consulting firm, ClearView Economics, from a home office outside of Cleveland, "I can't afford to look at all the indicators under the sun," the 55-year-old economist says. Rather, he starts with a trusted set of data to help shape his forecasts. Tops on that list is monetary policy. Mayland observed that when the Fed raises interest rates, "it always produces a slowdown of some magnitude."

As a result, he penciled in softer growth estimates for the second and third quarters of 2006 that were on target. Indeed, the only weak parts of Mayland's forecast were an expectation that the jolt to the economy from post-hurricane rebuilding would begin in the fourth quarter of 2005 and, similar to most economists, an underestimation of corporate profit growth.

Right now, his list of leading indicators points to even slower economic growth during the first half of 2007. Inventories are now growing faster than sales, a negative sign. "By looking at the ebb and flow of inventories," says Mayland, "you get good insight into when the economy is accelerating and decelerating." What's more, Mayland expects that the continued weakness in housing will take its biggest toll on consumer spending early in 2007.

What could be the biggest surprise of next year? According to Mayland, it may be a sharp slowdown in inflation, especially outside of food and energy. A softer economy will mean an easing of upward wage pressures and big drops in commodit prices. All in all, the economist believes tha the current slowdown will turn out to be a pause that refreshes, much like 1995. That year, the economy slowed sharply in the fir half but then bounced back strongly.

Mayland, an economist of 33 years and a graduate of the Massachusetts Institute of Technology and the Universit of Pennsylvania, has been working from home since 2000. That leaves him more time to spend with his wife and two sons, and more opportunities to grab his rod and vest for trout fishing. After spending so many hours knee-deep in economic data and traveling to meet with clients, Mayland says the intensity of fly-fishing helps to clear his mind. Judging by Mayland's performance in 2006, that's not ju another fish tale.

–By James Mehri

THE WINNING FORECAST FOR 2006

	REAL GDP (% CHANGE, ANNUAL RATE)				3Q (% CHANGE, YEAR-AGO)			3Q (QUARTERLY AVERAGE)		
	200S 4Q	2006 1Q	2Q	3Q	REAL GDP	CORPORATE PROFITS	CPI	FED FUNDS RATE	10-YR. TREASURY RATE	JOBLESS RATE
MAYLAND'S FORECAST	4.0	3.3	2.6	2.1	3.0	15.7	3.4	5.0	5.08	4.8
ACTUAL	1.8	5.6	2.6	2.2	3.0	30.9	3.3	5.25	4.68	4.7

Data: Bureau of Economic Analysis, Bureau of Labor Statistics, Federal Reserve

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Things Are Looking Up

THE *BUSINESSWEEK* ECONOMIC FORECAST SURVEY FOR 2007

NAME/ FIRM	REAL GDP QUARTERLY PERCENT CHANGE ANNUAL RATE 2007				YEARLY PERCENT CHANGE 2006 Q4 TO 2007 Q4			2007 Q4 LEVELS (PERCENT)			HOME PRICES** PERCENT CHANGE 2006 Q4 TO 2007 Q4
	I	II	III	IV	REAL GDP	OPERATING* PROFITS	CPI INFLATION	FEDERAL FUNDS RATE	10-YR. TREASURY YIELDS	JOBLESS RATE	
KATHLEEN CAMILLI Camilli Economics	3.5	3.2	3.4	4.0	**3.7**	7.0	3.4	5.25	5.50	4.5	5.0
ROBERT DiCLEMENTE Citigroup	3.0	3.7	3.2	3.5	**3.3**	6.0	2.4	5.00	4.80	4.6	-2.5
KURT KARL Swiss Re	3.9	3.1	3.2	3.1	**3.3**	8.7	2.4	4.50	5.00	4.5	7.0
JAMES PAULSEN Wells Capital Management	3.5	4.0	3.0	2.5	**3.2**	6.0	2.2	6.00	6.00	4.4	0.0
BILL CHENEY John Hancock Financial Services	2.9	3.0	3.2	3.2	**3.1**	6.0	2.5	5.25	5.00	5.1	-5.0
MICHAEL ENGLUND Action Economics	2.6	3.0	3.3	3.5	**3.1**	5.3	2.7	5.75	5.20	4.2	4.8
JOEL PRAKKEN / CHRIS VARVARES Macroeconomic Advisers	2.9	3.3	3.1	3.2	**3.1**	5.9	2.8	5.25	5.05	5.1	1.2
DAVID TEOLIS General Motors	2.6	3.2	3.2	3.1	**3.1**	6.2	2.5	4.75	5.40	5.1	3.5
RICHARD YAMARONE Argus Research	3.1	3.3	2.6	3.5	**3.1**	15.0	3.3	5.50	5.00	4.8	-10.0
DAVID LEREAH National Association of Realtors	3.3	3.1	2.8	2.8	**3.0**	8.0	2.0	4.75	5.00	4.8	2.5
ROBERT MELLMAN JPMorgan Chase	2.5	3.0	3.5	3.0	**3.0**	6.0	2.4	5.65	4.85	4.4	0.0
DONALD STRASZHEIM Roth Capital Partners	1.8	3.5	4.0	4.0	**3.0**	11.0	2.5	6.00	5.00	4.5	-12.0
DIANE SWONK Mesirow Financial	2.4	3.1	3.2	3.3	**3.0**	6.2	2.1	5.33	4.90	4.9	3.0
MARK ZANDI Moody's Economy.com	2.5	2.9	3.0	3.3	**3.0**	5.3	2.3	4.75	5.10	4.8	-1.5
DAVID BERSON Fannie Mae	2.8	3.0	3.0	3.1	**2.9**	6.0	2.7	4.58	4.65	5.0	-2.8
RICHARD DEKASER National City	3.3	2.7	2.5	3.1	**2.9**	1.9	2.4	5.00	5.50	5.1	-1.6
GENE HUANG FedEx	3.0	2.9	2.9	2.6	**2.9**	7.7	3.5	5.30	5.50	5.0	-3.0
WILLIAM HUMMER Wayne Hummer Investments	2.5	2.8	2.9	3.0	**2.9**	NA	2.4	5.00	5.00	5.0	-3.8
DEAN MAKI Barclays Capital	3.0	3.5	3.0	2.0	**2.9**	NA	3.4	5.90	5.05	4.3	NA
MICHAEL MORAN Daiwa Securities America	2.4	3.2	3.2	3.0	**2.9**	1.5	2.6	5.75	5.05	4.4	0.0
JOHN RYDING Bear Stearns	2.8	3.1	3.0	3.0	**2.9**	4.7	2.9	5.80	5.30	4.5	2.0
RICHARD BERNER / DAVID GREENLAW Morgan Stanley	2.3	2.7	3.1	3.2	**2.8**	1.4	1.8	5.25	4.78	5.1	1.0
DAVID SEIDERS National Association of Home Builders	2.7	2.8	2.9	3.0	**2.8**	5.7	2.4	5.00	4.90	5.0	0.5

The consensus of 58 forecasters is for steady growth.

BY JAMES MEHRING

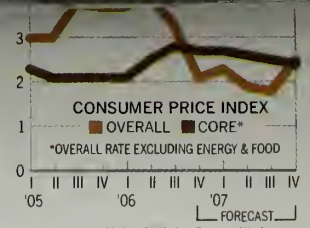
THE ECONOMY WILL steadily improve in 2007. That's the consensus view of the 58 forecasters in *BusinessWeek*'s annual economic outlook survey. Responses are sorted in descending order by fourth-quarter-to-fourth-quarter growth in real gross domestic product. For a quick take on all the numbers, we have compiled all the forecasts and charted the consensus view for specific indicators. Match the color of each data column with its color-coded counterpart to the right.

THE PROFIT PARTY CALMS DOWN

DAVID SEIDERS National Association of Home Builders	2.7	2.8	2.9	3.0	**2.8**	5.7	2.4	5.00	4.90	5.0	-0.5
JOHN SILVIA Wachovia	1.4	2.8	3.4	3.5	**2.8**	8.0	1.6	5.00	5.20	5.0	0.7
ETHAN HARRIS Lehman Brothers	2.5	2.8	2.8	2.8	**2.7**	7.0	3.5	5.25	4.80	4.7	0.5
DAVID KELLY Putnam Investments	2.0	2.5	3.0	3.5	**2.7**	11.3	2.1	5.25	5.25	4.7	-2.0
SUNG WON SOHN Hanmi Bank	2.5	2.6	2.5	2.8	**2.7**	5.9	2.6	5.25	5.00	4.5	2.0
MICHAEL CAREY Calyon Corporate & Investment Bank	2.0	2.4	3.2	2.9	**2.6**	6.3	2.7	4.75	4.78	4.7	-0.3
GAIL FOSLER The Conference Board	3.0	2.5	2.4	2.5	**2.6**	3.0	3.5	6.00	5.00	4.8	NA
MICKEY LEVY Bank of America	1.7	2.4	3.1	3.4	**2.6**	3.1	2.5	4.75	4.80	4.9	-2.5
GREGORY MILLER SunTrust Bank	1.4	2.4	3.1	3.5	**2.6**	16.0	2.9	4.50	4.90	5.4	2.0
JOHN POPE Investment Economics	2.5	2.4	2.6	2.8	**2.6**	14.3	3.5	4.75	4.80	4.9	-5.5
ROBERT SHROUDS DuPont	1.5	2.5	3.0	3.5	**2.6**	3.0	2.6	4.65	5.00	4.9	0.0
NARIMAN BEHRAVESH Global Insight	2.8	2.2	2.6	2.4	**2.5**	7.4	2.6	4.50	4.55	4.9	-1.4
KEITH HEMBRE FAF Advisors	2.2	2.6	2.5	2.8	**2.5**	3.0	2.0	4.50	4.50	4.8	-5.0
STUART HOFFMAN ⊡ PNC Financial Services Group	2.2	2.0	2.8	3.0	**2.5**	3.5	2.4	4.40	4.40	4.9	-2.0
KEN MAYLAND ⊡ ClearView Economics	1.4	1.5	3.2	4.0	**2.5**	1.2	2.4	4.50	4.17	4.6	-2.5
ALLEN SINAI Decision Economics	2.7	2.5	2.3	2.9	**2.5**	7.9	3.1	5.26	4.72	4.9	-5.0
CONSTANTINE SORAS ⊡ GunnAllen Financial	1.6	2.6	2.9	3.0	**2.5**	5.9	2.3	4.75	4.59	4.6	-1.3
ROBERT MCGEE US Trust	1.3	2.2	3.0	3.1	**2.4**	-2.5	2.3	4.20	4.35	5.2	-5.0
JOEL NAROFF Naroff Economic Advisors	2.3	2.1	2.8	2.4	**2.4**	-3.0	2.3	4.25	5.00	4.5	-2.3
NICHOLAS PERNA Perna Associates	1.9	2.4	2.4	3.1	**2.4**	4.7	2.7	4.94	5.44	5.0	-3.0
JOSHUA SHAPIRO MFR	2.6	2.4	2.5	2.2	**2.4**	2.5	2.6	5.00	4.40	4.8	-5.0
DAVID WYSS Standard & Poor's	2.9	2.1	2.1	1.9	**2.3**	5.7	2.6	4.70	5.00	5.0	-3.0
MAURY HARRIS ⊡ UBS	1.8	1.9	2.3	2.7	**2.2**	5.0	2.8	4.25	4.40	5.1	NA
JAN HATZIUS Goldman Sachs	2.0	2.0	2.0	2.5	**2.1**	2.3	2.8	4.13	4.68	5.1	-3.0
TOM HIGGINS Payden & Rygel	1.5	2.0	2.2	2.5	**2.0**	10.0	2.5	4.50	4.50	5.2	3.0
KEVIN LOGAN Dresdner Kleinwort	1.6	2.0	2.1	2.2	**2.0**	4.9	2.4	4.24	4.36	5.1	-2.5
PETER HOOPER Deutsche Bank Securities	1.5	1.9	2.1	2.4	**1.9**	9.0	2.1	5.00	5.00	5.2	0.0
LYNN MICHAELIS Weyerhaeuser	2.1	2.6	1.6	1.0	**1.8**	NA	3.8	4.80	5.30	5.4	-8.0
WAYNE ANGELL Angell Economics	1.2	1.0	1.2	1.8	**1.3**	9.0	1.0	4.20	4.10	4.5	-15.0
IAN SHEPHERDSON ⊡ High Frequency Economics	0.0	0.0	2.0	2.5	**1.0**	-8.0	2.5	3.60	3.70	5.6	-2.0
JAMES SMITH Parsec Financial Management	2.2	-1.4	-2.6	4.6	**0.7**	-6.1	0.8	2.50	4.14	5.0	4.7
CONSENSUS	2.3%	2.6%	2.7%	3.0%	**2.6%**	5.5%	2.5%	4.90%	4.88%	4.8%	-1.7%

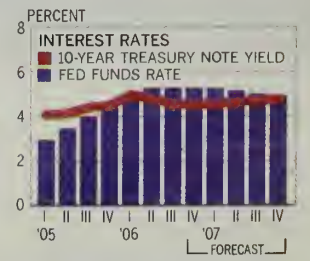
* Before-Tax Corporate Profits with IVA and CCA (NIPA BASIS). ** Office of Federal Housing Enterprise Oversight House Price Index. ⊡ Economist was a top five forecaster for 2006

CHARTS BY LAUREL DAUNIS-ALLEN/BW



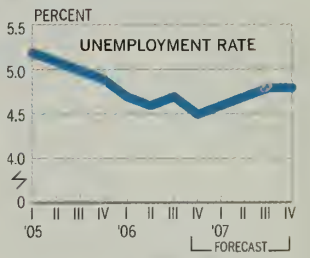
Data: Bureau of Labor Statistics, *BusinessWeek*

AS THE FED CUTS RATES, THE YIELD CURVE FLATTENS



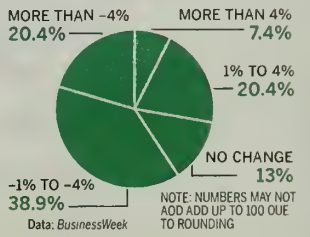
Data: Federal Reserve, *BusinessWeek*

THE JOBLESS RATE MOVES HIGHER



Data: Bureau of Labor Statistics, *BusinessWeek*

A BAD YEAR FOR MANY HOME SELLERS



Data: *BusinessWeek*

The Best Plays

The hottest sectors have changed. So have the smartest ways to navigate them

M&A PAGE 72

The swell party dealmakers have been enjoying isn't winding down anytime soon. Which sectors? Take your pick

IPOs PAGE 74

The once-moribund market surged in 2006, and the financial and tech sectors ought to keep powering it in 2007

GREEN BIZ PAGE 76

New leadership in Congress could mean more capital for environmental technologies to run on

BRANDS PAGE 78

Stocks of everyday goods have already been bid up. But there are still ways to enter, especially if you look abroad

ENTERTAINMENT PAGE 80

Internet video is galloping ahead—and you don't have to be Google to profit on it

EUROPE PAGE 82

Consumers on the Continent are spending big, and European equities are a canny way to hedge against a faltering dollar

EMERGING MARKETS PAGE 84

While not for the fainthearted, some of these markets have matured—which means more opportunities than ever

BRAZIL PAGE 86

Higher wages, plus lower inflation and interest rates, add up to consumers who are ready to spend

JAPAN PAGE 87

Sure, the Nikkei is wobbly. But Tokyo stocks haven't been this cheap in decades, and they may be poised for a comeback

TERRY ALLEN

LIBERTY
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An Irresistible Urge to Merge

The dealmakers will be working double time in '07, and in virtually every sector. BY JOSEPH WEBER

FOR DEALMAKERS, LIFE HASN'T been this good in years. Companies awash in cash and blessed with a benevolent economy, along with private equity players whose piles of capital keep growing, are driving mergers and acquisitions to new records, eclipsing much of the blockbuster action at the turn of the century. When the final tallies are in, dealmaking around the globe should surpass $3.44 trillion, nosing ahead of the $3.41 trillion record set in 2000 and moving up sharply from 2005's $2.74 trillion, according to Thomson Financial. The U.S. total, likely to climb beyond $1.39 trillion, will fall below the $1.71 trillion of 2000 but will finish well ahead of 2005's $1.15 trillion.

Next year could be even stronger. Dealmaking should accelerate in mining and energy, manufacturing, health care, finance, media, and transportation, according to analysts at Standard & Poor's. That should offset a slowdown expected in information technology and telecom. "Companies certainly have enough faith in not only the overall growth of the economy but also the growth potential of their own sectors," says Sam Stovall, chief investment strategist for S&P, which, like *BusinessWeek*, is part of The McGraw-Hill Companies.

There may be no hotter sector than finance. Take the headline-grabbing mergers among the stock and futures exchanges that are battling for domination of the public capital markets—the Chicago Mercantile Exchange is gobbling up the Chicago Board of Trade in an $ lion deal, the New York Stock Exc is buying Paris-based Euronext for $14.6 billion, and the NASDAQ Market is pursuing the reluctant l of the London Stock Exchange in expected to top $5.2 billion. The s ing players and rivals, such as Eu Deutsche Börse, are likely in 20 chase after partners in other venue ticularly in the Asian markets.

THE SUCCESS OF THESE big deals spark activity in other areas of fi Bankers who've been coy about g together, despite the overcapacit plagues their industry, could find common cause. "Our expectation M&A is going to pick up," says T B. Michaud, president of inves bank Keefe, Bruyette & Woods. The targets? Smaller banks that are f pressure on their earnings, thar part to the housing industry slow just as bigger banks are looking t JPMorgan Chase, Citigroup, and could swoop in on such prey as Wa ton Mutual, a prominent name on list of targets. The firm figures could fetch as much as $55 a sh respectable premium over its c $44, if it starts weakening. "If stumbled, it would make it more li be acquired," says Michaud.

Parts of the tech sector could pro too, for a second year. After all, the deal of 2006 was AT&T's $83 billio

BLACKSTONE'S KIND OF TOWN By snapping up Equity Office Properties for $36 billion in the largest private equity deal ever, the firm gets a sizable chunk of downtown Chicago

e of BellSouth Corp. While the broader om sector should slow, more wireless om outfits, some of which are joint ures by the likes of AT&T or Verizon munications, could be pushed together e rise of WiMAX, a wireless broadband native to cable and DSL that's giving industry a jolt. Smaller players such as l Corp. and US Cellular are vulnerable, ding to Kenneth M. Leon, an analyst S&P. A cable operator could even ge in and acquire the industry's only r independent nationwide wireless pany, Sprint Nextel Corp., Leon says.

ftware remains a fertile area for action. Tech giants such as EMC, lett-Packard, and Microsoft are very h on the prowl. Hewlett-Packard Co. out EMC to acquire Mercury Interac- Corp., agreeing to pay $4.5 billion for utfit, which makes testing software. shelled out $2.1 billion for RSA Se- y Inc. Candidates for a takeover now, S&P analyst Zaineb Bokhari, include t Software, Hyperion Solutions, and rmatica. Overall, the number of tech deals in 2007 should surpass those in '06, figures Boston investment bank Innovation Advisors. And 2006 was already a record-setter in the number of deals, estimated at 3,945—behind only 2000 in dollar value, at an estimated $248.4 billion. In 2000, dealmakers racked up $490 billion worth of tech deals, counting 2,871 of them, IA says.

IN THE OIL PATCH, growth-hungry energy companies could fuel another round of consolidation. Potential targets include Forest Oil, Plains Exploration & Production, and Cabot Oil & Gas, say analysts at Wall Street Access Corp., an independent research firm in New York. Analyst Bernard J. Picchi says the cost of buying a company is so much lower than the cost of starting new production that big ones, such as Marathon Oil, Hess, and Anadarko Petroleum, could reap huge gains in takeovers. Says Picchi: "It's going to be a huge year for M&A in the energy industry."

Along with hungry corporate buyers, private equity money in 2007 could drive many more deals across the board. A consortium of four private equity outfits, led by Blackstone Group, surprised industry watchers in November when it beat out a rival quartet led by Kohlberg Kravis Roberts & Co. to pay $17.6 billion for Freescale Semiconductor Inc., a Texas-based Motorola spin-off. It marked a new direction for the buyout barons, who are generally drawn to stable outfits with predictable cash flows that promise reliable debt payments. In the past, they have largely shunned volatile sectors such as chips. But with billions of dollars that must be put to work—more than $220 billion raised in just the first three quarters of 2006, according to Thomson Financial—the private equity buyers are out in force and eyeing less-likely areas.

With mountains of cash and an agnostic approach toward the industries they move into, private equity firms are looking far and wide. As they spread their influence, such giants as Blackstone, Bain Capital, and Thomas H. Lee Partners are setting the pace for more megadeals in 2007. Blackstone is snapping up commercial real estate powerhouse Equity Office Properties Trust for $36 billion, including the assumption of debt, in the biggest private equity deal ever, eclipsing the $33 billion 2006 takeout of hospital company HCA Inc. Likewise, Bain and Lee are hauling in radio giant Clear Channel Communications Inc. for $27 billion, including debt.

Whether it's private equity players driving the deals or companies that see the virtue of joining together, the activity is likely to be bustling in lots of sectors. "It's not like the last M&A boom, when technology deals were dominant," says Gordon Dyal, global head of mergers and acquisitions for Goldman Sachs Group Inc. "It's much more balanced across industry and regions." With his own backlog of pending deals now just about as rich as it was for much of 2006, Dyal expects '07 to be at least as busy.

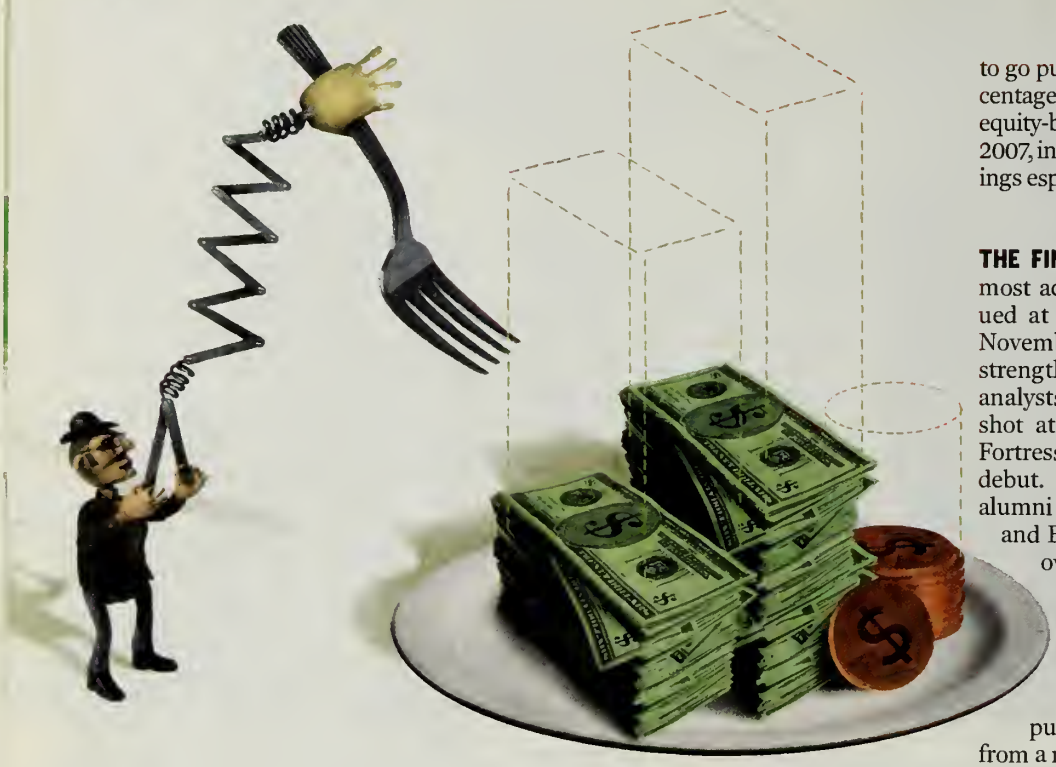
And as Asian and Russian companies continue to grow more prominent, dealmakers expect transactions among them to garner attention in 2007. Europe, already toe to toe with the U.S., could prove even more of a factor in the coming year. With globalization on the rise, M&A pros won't be shy about crossing borders. ■

KELY RGETS

money is burning le in their pockets. the key players pursuing, and why

SECTOR	HUNTERS	PREY	BUZZ
FINANCE	JP Morgan Chase, Citigroup, HSBC	Washington Mutual, Sovereign Bancorp, Valley National	Earnings of the smaller fry will come under pressure from a housing bust
TECH	Hewlett-Packard, EMC, Microsoft	Quest Software, Hyperion Solutions, Informatica	Buying is cheaper and faster than building
ENERGY	Marathon Oil, Hess, Anadarko	Forest Oil, Plains Exploration & Production, Cabot Oil & Gas	Natural gas could drive dealmaking more than oil

Data: Ke Bv tte R woods Standard & Poor Wall Street Access



IPOs Are Looking Tasty Again

Financial sector offerings paid off big, tech stocks are back, and 2007 promises more of the same. BY AARON PRESSMAN

THE ONCE-MORIBUND MARKET for initial public offerings heated up in 2006, giving savvy investors an opportunity to beat the market by a wide margin. IPOs gained 24% through Dec. 8, vs. a 13% gain for the Standard & Poor's 500-stock index, according to Renaissance Capital in Greenwich, Conn., as the amount of money raised jumped 19%, to $38 billion. Big winners included Chipotle Mexican Grill Inc., up 151% since January, and MasterCard, up 157% since May. In fact, the offerings for Chipotle and the New York Mercantile Exchange Inc. each doubled in their first day of trading, feats that hadn't happened in five years. And even investors who missed those first-day run-ups still saw healthy returns.

The market looks just as solid going into 2007. And as the economy slows (page 64), upstarts with strong growth potential will look more appealing, says David Antonelli, chief investment officer at MFS Investment Management in Boston.

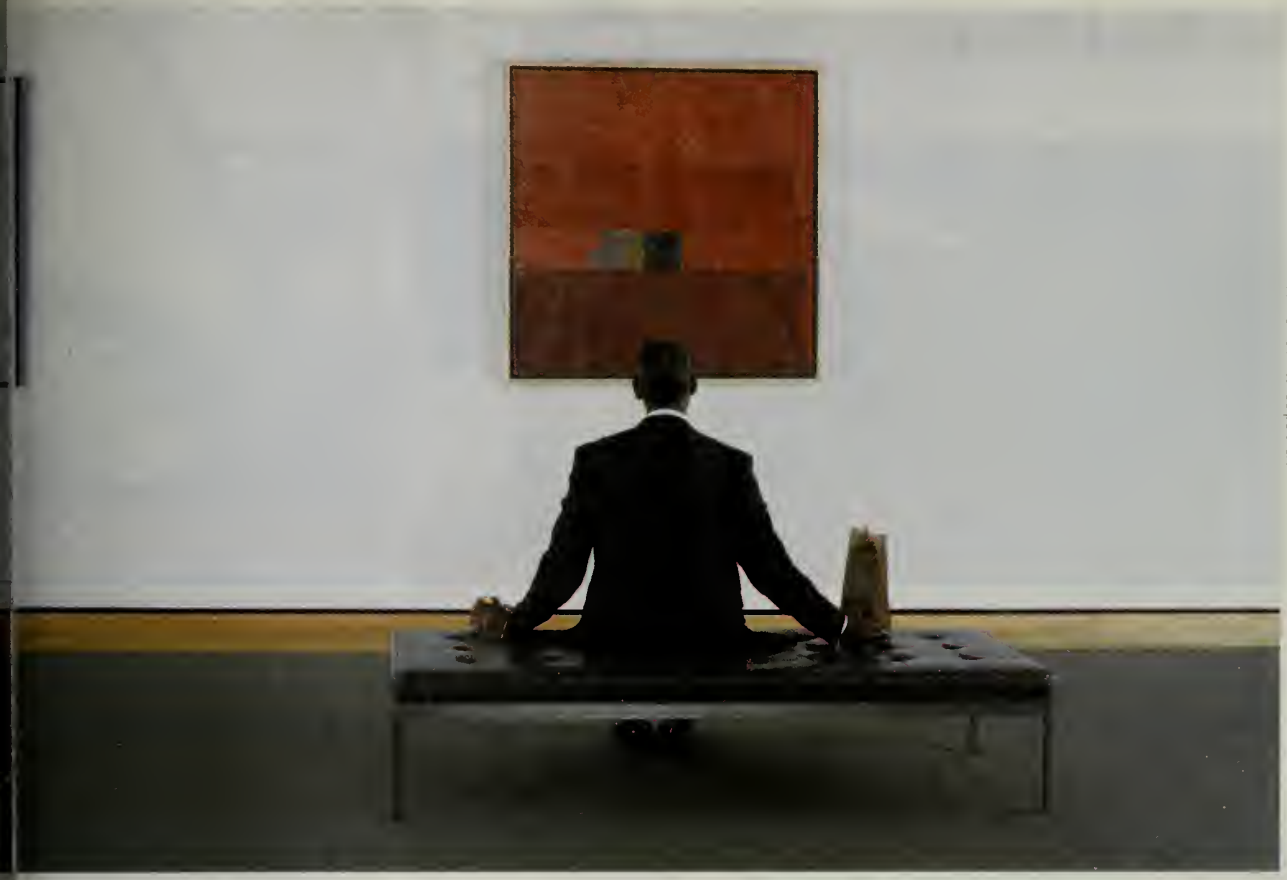
The private equity boom should keep feeding the IPO market directly. All told, buyout firms brought 77 issues to market in 2006 through Dec. 8, and their average gain was 23%, according to Dealogic. Not all private equity-backed IPOs perform well, of course. According to a study of almost 500 so-called reverse LBOs by professors Jerry Cao of Boston College and Josh Lerner of Harvard University, companies going public less than a year after being taken private trailed the return on the S&P 500 by almost five percentage points over the next three years. In contrast, more patient companies that waited more than a year to go public again beat the S&P by 24 centage points. With the docket of pr equity-backed IPOs expected to be thi 2007, investors should examine those ings especially carefully.

There were some duds, like Vonage and Traffic.com

THE FINANCIAL SECTOR PROVIDED most action in 2006, with 48 deals ued at $7.5 billion through the en November, according to Dealogic. strength is likely to continue in 2 analysts say. Investors will get their shot at the private equity boom v Fortress Investment Group make debut. The eight-year-old firm ru alumni of Goldman Sachs Group and Blackrock Financial Manage oversees $13.6 billion in privat uity money out of $26 billi total assets. The Chicago B Options Exchange Inc., or the few exchanges still in vate hands, is considering g public as well. First, it must co from a membership-owned group t owned by shareholders.

The slow but steady return of tech ogy IPOs is expected to continue. and telecom stocks generally did w 2006, helping push open the IPO dow, says Dan Genter, president of Genter Capital Management in Los geles. The S&P 500's tech index ga almost 25% from mid-July through 8. "Coming off a pretty good year, y finally seeing some recovery on the side, and there's plenty more to go th he says. A few companies that have to go public in early 2007 look pro ing. Francis Gaskins, editor of IPODc top.com, likes Supermicro Comp Inc., a computer-server maker that been profitable for 17 straight years boasts solid growth. Time Warner is expected to spin off its cable unit Gaskins says he'll wait to see how unit is valued relative to the rou $3,000 per subscriber figure for riva

There were some duds in 2006, including Web phone service pro Vonage Holdings Corp., down 58% its May IPO, and t site Traffic.com, d 35% since January. flops show that inve haven't forgotten bubble years. Says Walker, industry e at financial research Hoover's Inc.: "Th aren't rolling so that we'll just give ey to anyone." ■



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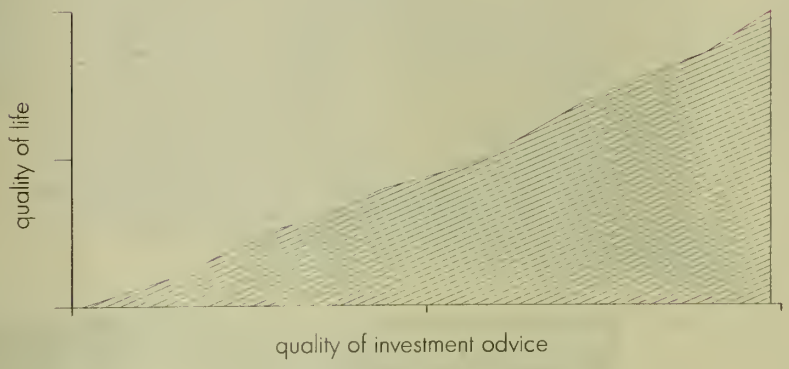
INVESTMENT ADVICE

and its effect an quality af life



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CATCHING A BREEZE
One pick: A maker of carbon fiber for wind turbine blades

Who Says It's Not Easy Being Green?

Investing in environmental technology may be more rewarding under the new Democrat-led Congress. BY EMILY THORNTON

SEVEN MONTHS AGO, THE SHARES of alternative energy producers were on fire. But a jittery stock market and plunging oil prices sent them tumbling. After surging 26% in 2006 through May 8, the Cleantech Index of 75 stocks was up just 5% in 2006 through Dec. 8, while the Standard & Poor's 500-stock index had risen 13%.

The slump is encouraging some analysts and money managers, who say bargains abound for investors willing to take a risk on people's desire to save the planet. Strategists tend to look past more familiar names, such as Pacific Ethanol and Suntech Power Holdings Corp., in favor of niche players. But most agree that the new, Democrat-led Congress is likely to benefit everyone in the green arena. In the first few trading sessions after the November election, for example, the PowerShares WilderHill Clean Energy Portfolio, an exchange-traded fund of clean-energy stocks, rose 5%.

One of the best opportunities might be in lighting. About 30% of the nation's electricity is used to fire up incandescent bulbs that haven't evolved in a century, says Matthew W. Patsky, portfolio manager of the Winslow Green Growth Fund. One of his favorite plays is Boston's Color Kinetics Inc., which designs light-emitting diode systems. Analysts expect the company to boost earnings to 47¢ per share in 2007, up from an estimated 27¢ in 2006, as it broadens its client list.

Another company on the rise: Fuel-Tech Inc. in Stamford, Conn. Fuel-Tech makes products that reduce emissions from coal-fired power plants. Analysts expect its earnings to rise to 42¢ a share in 2007, from an estimated 27¢ in 2006, thanks to more contracts with utilities in Europe, the U.S. East Coast, and, China. "We think there is an enormou portunity in energy efficiency," says Quealy, an analyst at Vancouver ir ment bank Canaccord Adams.

ONE WIND-POWER COMPANY that e analysts is Zoltek Companies Inc. Louis. Its lightweight carbon fiber is in large wind-turbine blades. An expect the company to book earnin $1.10 a share in fiscal 2007, up fron in 2006.

Diversification seekers might con Energy Conversion Devices Inc. An view the Rochester (Minn.) compa a triple threat: It's a leading mak solar panels, batteries for hybrid and energy-efficient chips for elect devices. Analyst Michael Horwitz a Francisco's Pacific Growth Equitie pects the company to earn $1 per next fiscal year, ending June, 200 from an 11¢ loss this year.

A more speculative and longer bet is Quantum Fuel Systems Tech gies Worldwide Inc. in Irvine, Calif. leading producer of automotive fu systems has landed orders from Ge Motors Corp. and Toyota Motor recently, according to Brion Tanc research analyst at Merriman Cu Ford & Co. It may be years before h of Americans drive cars that run on h gen. But Quantum Fuel's stock is tu at $1.74, less than a Starbucks latte profit potential a better buzz? ■

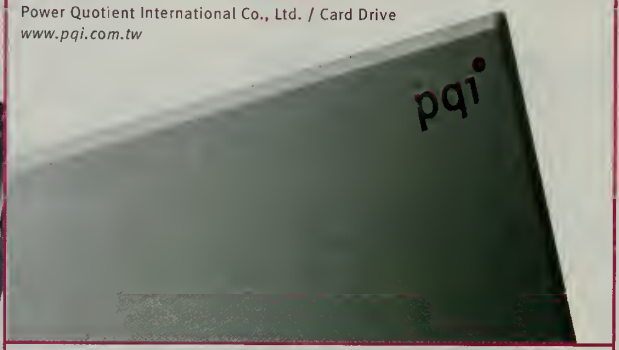
PLACES TO PUT THOSE GREENBACKS

COMPANY/SYMBOL	PRICE*	P-E RAT
COLOR KINETICS CLRK Brisk traffic in more efficient lightbulbs is reducing the country's electricity consumption.	$19.39	41
ENERGY CONVERSION DEVICES ENER Tech knowhow in everything from converting sunlight into power to building hybrid car batteries.	36.38	NA
FUEL TECH FTEK This company rules its niche: Products that reduce NOX and carbon emissions from burning coa	24.90	59
QUANTUM FUEL SYSTEMS TECHNOLOGIES WORLDWIDE QTWW The fuel cell technology is attracting big orders from automakers like General Motors.	1.74	NA
ZOLTEK ZOLT Its carbon fiber is becoming a key component in building larger wind turbines.	25.01	23

*Dec 8 **Based on earnings estimates for next fiscal year **Data:** *BusinessWeek*, Bloomberg Financial Markets, Thomson Financial Co

Giant Manufacturing Co., Ltd. /
Maestro Suspension Bike
www.giont-bicycles.com

Unitech Electronics Co., Ltd. /
Rugged VOIP PDA
www.unitech-adc.com



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The Mundane Never Looked So Good

Stocks of staple goods have already been bid up, but there are still some buys around. BY NANETTE BYRNES

NEW YEAR'S IS FOR FRESH STARTS, resolutions, optimism. Except, it seems, on Wall Street this year. There, Scrooge is in. With 10-year Treasuries now yielding less than two-year notes, investors seem to be preparing for a cold winter, or at least a cooler economy. For one group of stocks, that points to good times ahead. Consumer staple companies, the makers of the mundane—toothpaste, breakfast cereal, cigarettes—like chillier economic weather. That's when their stocks shine.

Smart investors like Morgan Stanley chief U.S. investment strategist Henry H. McVey, and James P. Cullen, manager of the Pioneer Cullen Fund, started their staples shopping last summer, inching their portfolios toward a more defensive posture. Since then the stocks have gotten pricier. Standard & Poor's Chief Investment Strategist Sam Stovall notes that as a group they trade at 17.1 times estimated 2007 earnings, vs. 14.4 times for the Standard & Poor's 500-stock index.

Good buys remain, though, particularly among multinationals with big emerging-markets exposure. "The expertise to penetrate markets—you have that or you don't," says Michael Embler, chief investment officer of Franklin Mutual Advisors, which manages the Mutual Series funds. He likes Nestlé, Altria Group, and L'Oreal. Rapidly growing middle classes in Russia, India, and Brazil make the argument even more compelling, he says.

Revenue growth for the group is
est compared to tech or energy, but
companies—particularly ones with
private-label competition—have fou
way to grow faster. That includes c
and gum maker Wm. Wrigley Jr. C
well as companies that figure out h
break into pricier categories. Proc
Gamble's Olay Definity anti-aging
lotion, for example, sells for $24 to
bottle in stores like Target and CVS,
what other Olay products commanc

Analyst William Chappell of Sun
Robinson Humphrey thinks this w
a good year for cost savings at P&G
as it integrates its 2005 acquisiti
Gillette. P&G has been studying Gill
shelf placement and retail promo
and its tracking systems, and is
applying those to other businesses
Chappell. On its own, P&G had or
growth of 4% to 6%, he says. Wit
lette, that should reach 5% to 7%.

FOR BARGAIN HUNTERS, THE che
slice of the sector is tobacco. The
had a good run in 2006, thanks t
elimination of some big lawsuits a
the industry, but remains cheaper
staple stocks overall. Mutual Series
bler thinks cigarette makers ove
could be headed for more consolid
which could warrant a look at Spai
tadis (TABF on the Frankfurt Exch
Britain's Imperial Tobacco and
Tobacco (JAT in Frankfurt). Emble
Altria's Philip Morris Internationa
as a possible acquirer.

On the opposite end of the spec
Groupe Danone's dairy and yogurt
make it a play on a trend toward he
er eating. The stock's up from a 52
low of 21 last January to 32.68, b
position in the fastest-growing se
in the food market—health food—
it a chance at further gains. ■

FIVE TO WATCH

COMPANY/SYMBOL	PRICE*	P-E RATIO**
ALTRIA GROUP MO Cheaper p/e with upside of a potential breakup of tobacco and food	84.83	15
GROUPE DANONE DA Healthy foods in an era when people care about what they eat	32.68	23
L'OREAL OR*** Great brands; innovative, well-positioned overseas	100.51	23
PROCTER & GAMBLE PG Should start reaping more benefits from its Gillette mega-acquisition	63.89	19
WM. WRIGLEY JR. CO. WWY Well positioned in a segment with little private-label competition	52.50	24

*Dec. 8 **Based on earnings estimates for next fiscal year ***Trades on the Paris stock exchange, converted from euros.
Data: *BusinessWeek*, Yahoo! Finance, Merrill Lynch & Co., HSBC Holdings, Thomson Financial, Bloomberg Financial Markets

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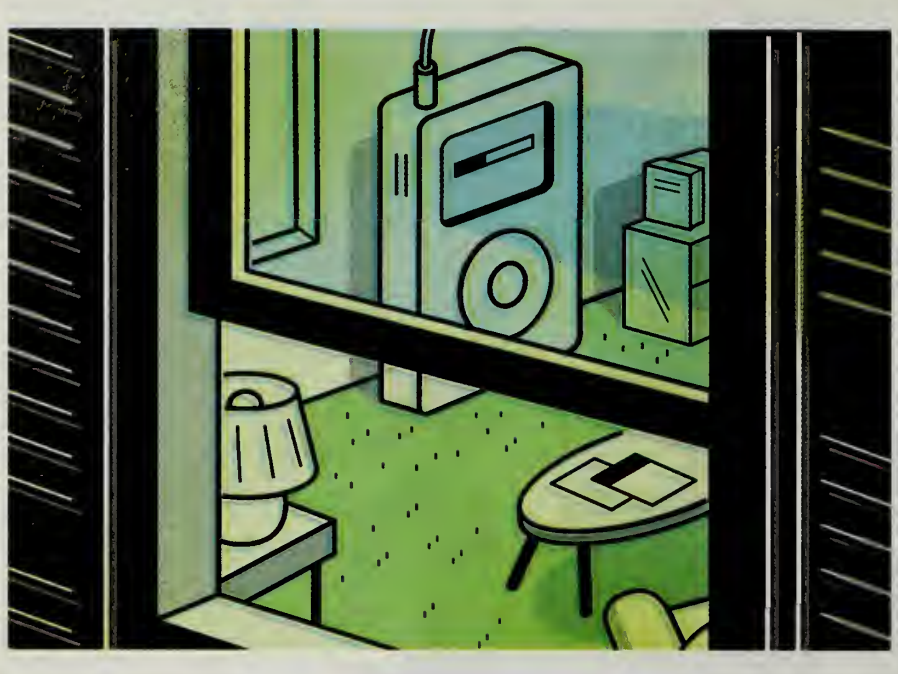

Downloading the Video Windfall

Broadband is making Internet video more compatible with other media. BY RONALD GROVER

FEW BUSINESSES SEEM POISED to create instant wealth quicker than Internet video. Just ask YouTube Inc. founders Chad Hurley and Steve Chen, who sold their two-year-old company to Google Inc. for $1.65 billion. For the rest of us, finding a profitable way into the world of Internet video is trickier. For one thing, it's not yet clear just how companies will make big money by providing warmed-over network sitcoms or animated snippets of a frog in a blender.

Still, the blizzard of press releases heralding the availability of *Lost* for video iPods and MySpace.com clips on cell phones may actually point to a real business forming. ABC Inc. alone has streamed more than 12 million episodes of shows like *Desperate Housewives* and *Lost*. By late 2007, more than half of all U.S. homes will have broadband connections, according to Plano (Tex.)-based research consultancy Diffusion Group; each day more people use those wires to hunt for videos.

FIVE TO WATCH

COMPANY/SYMBOL	PRICE*	P-E RATIO**
COMCAST CMCSA	42.11	32
Ramping up user-generated and video-on-demand broadband channels		
JUNIPER NETWORKS JNPR	20.02	23
Networking solutions company is helping telcos deliver TV over the Net		
NDS GROUP NNDS	48.21	18
Little-known player may be first to link satellite users with Net TV shows		
NETGEAR NTGR	26.44	17
Its gear could be a hit with telcos looking to zap Net shows to TVs		
NEWS CORP. NWS-A	21.63	18
Media giant streams *Prison Break*, other shows on MySpace.com		

*Dec. 8 **Based on earnings estimates for next fiscal year
Data: UBS, Oppenheimer & Co., JMP Securities, *BusinessWeek*

The race to get into consumers' ho iPods, and cell phones is cutthroat. P companies are taking on cable panies with Internet-based TV sh and Google, MySpace, and others launched video services. "In an arms like this, the best place to invest is the arms merchants," says Samuel son, an analyst with San Francisco-b JMP Securities. With some except that means buying suppliers of the ware, boxes, and wires that zap co from the Net to folks' homes.

One promising player is Juniper works Inc., which is making inroads telcos gearing up to launch Internet tocol TV—TV shows delivered ove Net. Re-arming cable players like cast Corp., which offers online cha for user content and video-on-der (VOD) programs, will likely be Ne Inc., a supplier of wireless netwo gear. In the wake of deals with sat operator BSkyB and Vodafone Gro Europe, Wilson expects Netgear to a second wave of growth in the U.S.

FOR ALL THE HYPE about Internet v many folks still want to curl up in fr their TV, not their computer. That to the strengths of NDS Group, a B company 74%-controlled by News NDS software protects TV signals piracy for News Corp.'s satellites an likely winner as satellite companies compete with cable's VOD offerings is working on software for a "hy set-top box to stream TV shows fro Net to satellite users. Because of its Corp. link, it's guaranteed to get it vice rolled out quickly on News Cor ellites. Streaming shows like those News Corp.'s game site Entertainment Inc. send the stock to 55 48, says Oppenheimer analyst Alan Bezoza.

News Corp. itself ha come a king of the Net buying MySpace in President Peter Chernin MySpace will generate than $500 million in revenues and is "with million or so of profi ity now." By the end "they'll be getting more revenue from My and IGN," says Merrill & Co. analyst Jessica Cohen, which could ser stock to 27, up almost from its current 22.60.

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PROFIT PROTECTOR & POCKET PROTECTOR

A new day is dawning

TOSHIBA bridges the gap between finance and IT with e-BRIDGE technology. Tech gurus geek out on this network-ready solution that manages, distributes and controls data via the network. The finance department loves uptime tools that automatically alert you when toner is low, service is necessary, or parts and supplies are needed. It's a new day. At least it is until tomorrow. *LetTheHarmonyBegin.com*

TOSHIBA

Lead.

Not Too Wild, Not Too Mild

European stocks should see respectable growth—and even outperform the S&P 500. BY STANLEY REED

IS IT TIME TO GIVE THE OLD WORLD a new look? With the dollar falling and U.S. growth slowing, Western European stocks may offer investors a good way to hedge the vulnerable greenback. And despite Old Europe's reputation for lackluster growth, the region may well outpace the U.S. in 2007 while offering less volatility than developing countries farther east. Western Europe "is in a sweet spot" because of its access to both cheap labor and fast-growing markets in the old Soviet bloc, says John Bennett, investment director for London-based GAM, a subsidiary of Swiss bank Julius Baer Group.

That's not to say buying into European shares is a sure bet. The Continent's bourses are already high after strong performances in 2006, with Morgan Stanley's MSCI Europe index up 13.6% for the year. The two major central banks, the Bank of England and the European Central Bank, are raising interest rates, which could cut into growth. And if the greenback keeps falling, earnings at European companies that depend on exports to the U.S. and Asia could take a big hit.

But many fund managers and strategists say there are still reasons to be bullish. European corporate earnings per share will likely grow by 6% this year, Morgan Stanley predicts. Although that's well below the 12% level of 2006, it's still slightly above the 5.5% increase the bank is predicting for the Standard & Poor's 500. And despite the runup in European shares in 2006, prices for the 600 companies in the MSCI Europe index are still a relatively modest 13.3 times the earnings forecast for 2007, on average. Compare that with the long-run rat 14.5 for the index, and there's poten room to grow. Total returns for the Europe will likely reach 13%, Mo Stanley says, compared with a 9.7% in the S&P 500.

TAKEOVERS COULD ALSO HELP lift ern European stocks, as companies i region sport balance sheets heavy cash. Europe looked set to finish slightly ahead of the U.S. as a sour deals. This strong flow of acquisi is likely to continue, unless a big bu blows up and kills investors' appeti putting up financing. "Private equity and publicly quoted M&A will be a r support for equities going through year," says Peter Oppenheimer, he European strategy at Goldman, Sac Co. in London.

Germany, which has dragged European growth for a decade, also like it's finally getting its mojo Years of restructuring and a massive of manufacturing to Central and Ea Europe have helped make German panies more competitive and bo demand for their products in new kets to the east. Even more impo long-dormant German consumers, account for about a third of the euro market, are waking up thanks to m real wage growth after four years

DING IN EUROPE
lers such as H&M
enefit from the
umer revival

Although a rise in the value-added 19% from 16% in January may have npening effect, investors still think 's tremendous pent-up demand. average age of a car in Germany is years, much older than the Europe ge," says Christoph Berger, manag- the Fondak Europa fund for comin- Commerzbank's fund management "The average German bathroom is ars old," he says.

ere is a lively debate on how inves- ought to play this consumer re- One bet is Swedish clothing retailer , which makes more than a quarter sales in Germany, says Teun Draa- Morgan Stanley European equity gist. Another good play might be id-listed Inditex Group, the parent any of retailer Zara, says David , director of European equities at on-based F&C Asset Management FACAM). "We think the European mer is in better shape than in a derable while," he says.

chnology outfits may also present op- nities. Swedish telecom equipment r L.M. Ericsson is relatively cheap t 15 times expected 2007 earnings, says. He thinks Ericsson's move to up a business running networks for rs will both increase its revenues rovide insurance against the cycli- wnturns that have pummeled it past. Other fund managers favor h telecom giant BT PLC, which they ay not be getting as much credit deserves for its potential to gener- venues through new services such as broadband and video-on-demand.

Some are betting on old standbys such as property and cars. For his GAM European Small Cap Hedge fund, Bennett is buying German real estate companies such as VIB Vermögen—which invests in office parks and industrial sites in southern Germany—and Deutsche-Wohnen, which has 22,000 residential units around Frankfurt and beyond. He is hoping for a revival in German real estate, which has stagnated even as property in Britain, Ireland, and Spain has boomed. Bennett also likes Porsche. The carmaker's recent accumulation of a 27% stake in Volkswagen could pay off for Porsche shareholders if VW's weak results improve. Porsche is "one of the few genuine growth stocks in Europe," Bennett says.

ONE OF THE STRANGE features of 2006 was a buying frenzy for utilities and infrastructure companies. Even as some traditional growth plays fell out of favor, private equity firms and strategic investors bid for Thames Water, Scottish Power, British airport operator BAA, and others, driving up prices in sectors that had been considered dull, if predictable. Now some fund managers seem to be shedding utilities and infrastructure while hunting for bargains in telecommunications, media, and technology—all sectors that have stumbled in recent years. Two picks from Morgan Stanley: cellular carrier Vodafone and Italian broadcaster Mediaset. Unpopular now, both could do well in 2007 as investors look for stocks with growth potential that haven't yet been bid up to the levels of the top performers of recent years. ■

—With Jack Ewing in Frankfurt

E TO WATCH

NY/SYMBOL	PRICE*	P-E RATIO
SSON ERIC (ADR)	39.65	16**
some tough times, the phone gear maker is making a comeback.		
HMB.ST (Stockholm)	46.38	24***
ltrahip Swedish clothing retailer is expanding worldwide.		
ONAL BANK OF GREECE NBG (ADR)	8.97	12**
ank is poised for growth as Greeks get smarter about finance.		
O CHE POR.3F (Frankfurt)	1,172	14†
s in the carmaker look ready to accelerate.		
O FONE VOD (ADR)	27.10	12††
orld's biggest cellular carrier has fallen out of favor but could soon bounce back.		

oomberg Financial Markets *Dec 8 Based on projected earnings for year ending **12/07 ***11/07 †7/07 3/08

2007's Hottest Business Topics.

Hot Business Topic	IESE Short Focused Program
Managing technologies, changing business	New Technology Playgrounds Jan 30-Feb 2 Barcelona
Understanding emerging markets: an insider's perspective on India	Inside India Feb 19-23 India
Evaluating and developing your leadership talents	Developing Leadership Competencies Mar 12-16 Barcelona
Integrating your global supply chain for value creation	The Global Footprint Mar 27-30 Barcelona
Understanding emerging markets: an insider's perspective on China	Inside China Apr 16-20 China
From the drawing board to implementation	Getting Things Done May 8-11 Barcelona
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Dipping a Toe In the Risk Pool

The safest way to invest: Focus on companies that serve rising middle classes in maturing economies. BY FREDERIK BALFOUR

LIMA, HO CHI MINH CITY, CASAblanca, Zagreb: exotic locales whose stock markets delivered equally exotic returns in 2006. Before you consider plowing your kid's college fund into these sizzling bourses, though, bear in mind that the developing world's highfliers are often small, illiquid, and highly volatile. After a 175% run-up in 2005, Dubai plunged by 44% in 2006. And Vietnam may be up 136% this year. But between April and July, it fell by 35%. Its market capitalization, meanwhile, is all of $5 billion—or about the size of a U.S. mid-cap company.

While any emerging market could plummet in the coming year, for investors with a good stomach for risk and a focus on the long haul, maturing countries such as China and India offer better opportunities than ever. And it's getting easier to invest in them, thanks to a surge in developing country funds and overseas companies that also trade in New York or London. "Emerging markets hold strong potential not only for this year but over a few decades," says Carlos Asilis, a manager at New York-based Vega Capital Partners.

Fans of developing markets to substantial macroeconomic refo Burned by the economic crises o

SIGN OF THE TIMES
Low-tech delivery of high-tech gear in Vinh, Vietnam

HOANG DINH NAM/AFP/GETTY IMAGES

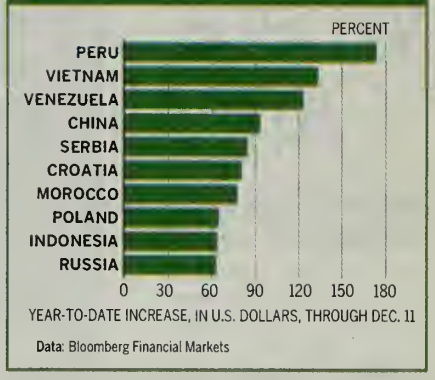
9', countries such as Thailand and e:o have adopted floating exchange te Russia and Brazil, once deadbeat r wers, now run trade surpluses and v built up sizable reserves.

Cobalization too, has changed the way people look at emerging markets. In the past their fortunes were often tethered to the whims of U.S. consumers. Today, China has become an important growth engine whose insatiable demand for minerals and oil has fueled the bourses in Peru and Venezuela. What's more, developing world companies such as Russian mobile carrier VimpelCom, Indian outsourcing shop Wipro, and Brazilian aircraft maker Embraer are all world-class. "The distinction between emerging and developed markets has blurred," says Mark Dow, a manager at New York hedge fund Pharo Management.

Many experts say the best way to capitalize on emerging economies is to focus on companies that serve their burgeoning middle classes. As salaries in developing countries rise, more consumers will want bank loans, cell phones, flat panel TVs, and more. Retail investors would do well to put as much as 10% of their portfolio into developing markets where "the demographics are very supportive of future growth," says Kurt A. Umbarger, an emerging markets specialist at T. Rowe Price in Baltimore. He is particularly keen on China and has been loading up on Ping An Insurance and Industrial and Commercial Bank of China.

To be sure, emerging markets can be a white-knuckle ride. But by focusing on star performers in bigger countries with sensible economic policies, patient investors may do very well indeed. ■

TOP 10 EMERGING MARKETS IN 2006



Data: Bloomberg Financial Markets

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INVESTMENTS

Smart move.

Where Consumers Are All Keyed Up

You're too late to cash in on Brazil's commodities boom, but conditions are ripe for a serious spending spree. BY GERI SMITH

COMMODITIES HAVE BEEN GOOD to Brazil. Thanks to high prices for the iron ore, steel, soybeans, and other products the country exports by the shipload, Brazil is set to post a $45 billion trade surplus this year. Some of its mining and metals companies are so cash-rich that they're snapping up rivals from Europe to Canada.

But investors looking for high returns in 2007 should skip commodities. A better bet would be companies that serve the 180 million consumers in Latin America's biggest country. Sure, nearly half of them are poor, but with inflation and interest rates dropping and wages rising, nearly everyone can afford to buy a cold beer, a mobile phone, or another shade of lipstick. "For the past four years, commodities were where the action was [in Brazil], but the easy money already has been made in those stocks," says Geoffrey Dennis, head of Latin America equity research for Citigroup. "Now the focus is on consumption."

Fiscal discipline in Brasilia is fueling a buying binge. President Luiz Inácio Lula da Silva, a leftist former union leader, has pursued economic policies that have helped bring inflation down to just 3% from nearly 15% three years ago. Wages are up, and the government is making payments of as much as $60 a mon 11 million poor families that keep children in school. Add them up, these measures have reduced poverty driven consumer spending. Althoug economy is expected to expand just this year, the consensus among ec mists is 3.5% for 2007. Growth has g a further boost from a decline in int rates, which were 25% when Lula took office in 2003. Today they sta 13.25% and may well continue fallin

Lower rates mean more consu are taking out mortgages. That's to add up to a big increase in cons lending at Banco Itaú, trading at 12.6 times earnings, and Unib trading at 9.8 times. An way to cash in on falling is with housing stocks as Cyrela Brazil Realty, developer of high-end a ment complexes and towers, where profits a pected to jump by a thi 2007. "The housing m in Brazil will tick up as est rates come down," Jeff Urbina, co-manag the William Blair Eme Markets Growth fund.

Stocks with a strong sumer focus should als a lift as Brazilians feel more flush. Low-cost a Gol Linhas Aereas, serves 55 destinations in zil and five abroad, could be a goo Latin America's largest bottler, Con hia Bebidas das Américas (AmBev consolidated the regional brewing m and will likely prosper as more Braz drink its Brahma and Skol beers. S demand for high-speed Internet and services could give a boost to Telesp São Paulo fixed-line carrier is cont by Spain's Telefónica and offers an a tive dividend yield of 10%.

Cosmetics maker Natura look a natural winner. The company, makes skin-care products from l plants, and native oils, saw its jump by 22% in the first three qu of 2006. Natura sells its produc a network of more than a half-m independent agents. In 2005, N moved into France as well. The co ny's sales could grow by 21% in boosting profits by 19%, says Da Fraser, head of Latin America res for UBS Pactual. "Natura," says F "is one of the best, fastest-growing panies in Latin America." ■

DIALED IN Telefónica-owned Telesp is poised for growth

FIVE TO WATCH

COMPANY/SYMBOL	PRICE*	P-E RATIO**
BANCO ITAU ITU (ADR)	34.23	12
One of Brazil's largest and most profitable banks, Itaú is benefiting from drop in interest rates.		
COMPANHIA BEBIDAS DAS AMERICAS (AMBEV) ABV (ADR)	47.53	15
Latin America's biggest soft-drink and beer bottler is frothy due to higher consumer spending.		
GOL LINHAS AEREAS GOL (ADR)	29.55	14
Brazil's pioneer low-cost airline is flying high as the economy picks up steam.		
NATURA NATU3 (São Paulo)	13.58	21
This fast-growing cosmetics company that focuses on natural ingredients is expanding to Europe.		
TELESP TSP (ADR)	23.53	15
Fixed-line telecom operator controlled by Spain's Telefónica is paying strong dividends.		

Data: Bloomberg Financial Markets * Dec 8 ** based on earnings estimates for 2007

it Back, Enjoy he Ride

oks like all the pieces in place for a rebound apan. BY KENJI HALL

MOVE OVER, GM Toyota's ascendancy has been a boon for its suppliers

VESTORS WHO BET ON JAPAN IN 006 may feel down on their luck. fter the benchmark Nikkei 225 in- ex surged to a 15-year high in April, e market sputtered. Between May d November, the Nikkei lost nearly s. a gain of 10% for the Standard & s 500-stock index, sending foreign- the exits. Net purchases of Japa- stocks by international investors d around $35 billion in the first 11 hs of 2006, compared with $85 bil- luring the same period in 2005.

e "Buy Japan" camp, though, is g put. The main reason: Stocks n't been this cheap in decades, at when compared with U.S. shares. Japanese issues are trading at about nes forecast 2007 earnings, vs. an ge of 15 for S&P 500 shares. But the Nikkei peaked in 1989, they ged more than 58 times earnings, excluding financial stocks, vs. a multiple of about 13 for the S&P. The figures look even better when you consider that Japan's interest rates are the lowest of any industrialized country—and low rates tend to push price-to-earnings ratios higher. Since the Bank of Japan is wary of choking off growth by ramping up rates too quickly, there's little chance of p-e's taking a dive anytime soon.

The relative strength of Japan's economy helps, too. With banks no longer groaning under huge debt and deflation a thing of the past, the market appears poised for a comeback in 2007. Nomura Securities Co. predicts a 10% rise in the Topix index by yearend. "The market has been so bad there's potential" for a turnaround, says M. Campbell Gunn, a fund manager at T. Rowe Price Group Inc. in Tokyo. Another draw: Japanese companies are getting more generous with dividends, notes Kathy Matsui, chief equity strategist for Goldman Sachs & Co. Japan. Payouts are now running at 23% of earnings, up from less than 19% in May.

What sectors should you load up on? Tech equipment and transport, says Shinichi Ichikawa, an analyst at Credit Suisse First Boston. His picks include Toyota Motor Corp., which forecasts a nearly 20% jump in operating profit in the year through March, 2007, and is likely to overtake General Motors Corp. as the world's No.1 carmaker soon. Toyota's ascendancy has been a boon for suppliers such as Denso Corp., where Ichikawa sees double-digit profit growth as the company steps up sales of car navigation gear and hybrid engine parts.

YOU CAN ALSO FIND GEMS among Japan's precision tech specialists. Look for companies with niche technologies used in flat-screen TVs, iPods, and digital videorecorders, recommends Ryoji Musha, Deutsche Securities' chief investment officer in Tokyo. One is Nidec Corp., which has 71% of the global market for tiny motors that power hard drives used in DVRs and portable music players. Musha also likes Toray Industries Inc., a carbon fiber specialist and key supplier to jetmakers Boeing Co. and Airbus.

While many investment pros are bullish on Japan right now, a few skeptics worry about the impact of a U.S. slowdown. True, Americans buying Toyota sedans, Canon cameras, Panasonic TVs, and the like have helped to bankroll Japan's recovery. But with the economy back on its feet, Japanese stocks just might rebound regardless of what happens across the Pacific.

E TO WATCH

NY/SYMBOL	PRICE*	P-E RATIO**
N CAJ (ADR) les of digital cameras and printers surge, Canon's stock should get a lift	55.70	17
O DNZOY (ADR) ar parts maker is riding Toyota's coattails	150.75	17
NJ (ADR) demand for hard drives should keep this component maker's stock climbing	19.46	20
Y INDUSTRIES 3402 (Tokyo) s shares are flying high as Boeing and Airbus buy its carbon fiber for their planes	7.40	19
TA TM (ADR) 's top automaker is on track to unseat GM as the world's No. 1	121.99	14

** Based on earnings estimates for the year ending March, 2008

Data: Bloomberg Financial Markets

Smart Strategies

From stocks to sculpture, how the savviest investors stay one step out in front

INCOME PAGE 90

Looking to maximize income? The best place for fat—and safe—returns may be where you least expect it: In your savings account

PORTFOLIOS PAGE 94

In an everyone's-an-expert marketplace, how to filter all those hot tips into practical, cohesive advice

CURRENCIES PAGE 102

The dollar isn't likely to pull out of its dive, but exchange-traded funds and other instruments offer safe harbors

MUTUAL FUNDS PAGE 104

While big-company funds have been lagging their small-company counterparts for some time, the gap is narrowing fast

SELLING STOCK PAGE 110

Dumping those sagging shares can be as painful as severing any past-its-prime relationship. Four ways to tell if it's time to let go

HOUSING PAGE 114

You've probably been hearing the worst is over. Don't believe it: Some parts of the country could take 15 years to recover

ART PAGE 116

Collectors are turning to India, China, and other nations where the art scene is not only vibrant but quite possibly undervalued

TERRY ALLEN

LIBERTY
IN GOD WE TRUST
2006

Why Cash Could Be King

Looking for the highest, safest yields? You may want to open a savings account. BY ADRIENNE CARTER

THERE'S NO QUESTION THAT income is an important piece of the investment puzzle. But where's the best place to get it in 2007—bonds, stocks, or cash?

You can't look to the financial markets themselves for guidance, since they're sending decidedly mixed signals (page 54). Consider the schizophrenic bond market. In corporate bonds, the yields of high-grade issues and junk aren't all that different. Such ultratight spreads typically indicate that investors are optimistic about corporate profits. Yet at the same time, rates on long-term U.S. Treasury bonds are lower than rates on short-term notes, a situation that has presaged each of the six recessions in the past 37 years. "The government bond market is signaling a massive slowdown, while the credit market is saying everything is fine," says James Swanson, chief investment strategist for MFS Investment Management.

With so much confusion out there, cash might be one of the best income wagers for 2007. It's among the safest investments around, and rates are fairly generous at the moment: Many high-interest savings accounts and money-market funds are yielding 5% or more. Compare that with roughly 4.49% to 4.66% for U.S. Treasuries across the spectrum of maturities. You're not likely to find the best rates at your local bank, so do a little comparison-shopping at a site such as Bankrate.com.

Among the best deals: HSBC Direct and Citibank offer online accounts with no fees, no minimum balances, and an annual percentage yield of around 5%. Mutual-fund shops Vanguard Group Inc. and TIAA-CREF have money-market funds with rates of 5.1%. Of course, savings accounts and money-market funds move up and down with rates (although money-market funds tend to lag a bit more). If you want to lock in a rate, buy a certificate of deposit (CD). CDs at ING Direct, which come in terms of six months to six years, boast yields of 5% or more.

FOR A LITTLE EXTRA juice, check out bank loan funds, which invest in floating-rate corporate loans issued by banks or other financial institutions. The rates on such investments move up and down with short-term interest rates; right now the average is around 7%. The extra yield compensates for added risk: These loans are usually below investment grade or not rated at all. Floating-rate loans are strong performers in rising-rate environments, as we've had in the past year. But they're also a good call in times like now—when riskier, long-term junk issues have similar yields.

Morgan Stanley Prime Income Trust boasts a yield of 6.7%. Its managers favor companies with hard assets and good cash flows backing their deals, qualities that help mitigate the credit risk. You'll get a slightly lower yield of 5.99% from the Fidelity Floating Rate High Income Fund. But the no-load portfolio, which mostly owns the loans of large companies and keeps a nice stash of cash on hand, is one of the highest-quality and lowest-cost portfolios in the group.

The high-grade corporate bond
ket is a bit treacherous at the mor
Private equity funds have billio
dollars at their disposal, money th
using to buy out companies and
them to the gills with debt. T
an especially hazardous scenari
bondholders of investment-grade
porates. Surprisingly, the owne
junk bonds usually have more pr
tions in such situations. On bu

BEST BETS

Whether you're looking for a sure-thing CD or can stomach some extra risk, here are our picks for income investments:

CASH	YIELD
ONE-YEAR CD, AMTRUST DIRECT	5.41%
VANGUARD PRIME MONEY-MARKET FUND VMMXX	5.11
TIAA-CREF MONEY-MARKET FUND TIRXX	5.10
HSBC DIRECT SAVINGS ACCOUNT	5.05
CITIBANK E-SAVINGS ACCOUNT	5.00
BANK LOANS FUNDS	**YIELD**
MORGAN STANLEY PRIME INCOME TRUST XPITX	6.70%
FIDELITY FLOATING RATE HIGH INCOME TRUST FFRHX	5.99
PREFERRED STOCKS & CLOSED-END FUNDS	**YIELD**
NUVEEN PREFERRED & CONVERTIBLE INCOME JPC	7.48%
BLACKROCK PREFERRED INCOME STRATEGIES PSY	6.86
CITIGROUP PREFERRED 2066	6.45
DIVIDEND STOCKS	**YIELD**
TRAFFIX TRFX	6.05%
DATARAM DRAM	5.67
VERIZON COMMUNICATIONS VZ	4.54
U.S. BANCORP USB	3.88
PFIZER PFE	3.82
WELLS FARGO WFC	3.05
DIVIDEND FUNDS	**YIELD**
THORNBURG INVESTMENT INCOME BUILDER TIBAX	3.74%
ISHARES DOW JONES SELECT DIVIDEND INDEX DVY	3.10

Data: Morningstar, New York Stock Exchange, company Web sites

w at Clear Channel Communica-
n nc., the yields on some of its old-
b ds zoomed as the price dropped
ec itously. "[LBO risk] is a real and
es t danger from a bondholder's
rs ctive," says Thomas H. Atte-
rr co-manager of FPA New Income
In which has a 4% weighting in
rp ate bonds right now, in part be-
s of such risks.

In stors can find shelter in the highest-quality bonds of large banks, insurers, and utilities, since such businesses are rarely private equity targets. But for extra yield, consider preferred stocks, which trade on exchanges but pay out a fixed interest rate like a traditional corporate bond. Right now, investors can find yields of 6% to 7% on a high-quality preferred stock, compared with 5% to 5.5% for similar corporate bonds. A recent 30-year issue from Citigroup that was callable in five years had a yield to maturity of 6.45%. Closed-end funds that specialize in preferred stocks can amp up yields. Look for funds that trade at a discount to their net asset value, such as BlackRock Preferred Income Strategies Fund (6.86% yield) and Nuveen Preferred & Convertible Income Fund (7.48% yield).

DIVIDENDS SHOULD BE PLENTIFUL in 2007. Flush with cash, many companies have been steadily increasing their payouts. The Standard & Poor's 500-stock index now has a dividend yield of 1.8%, compared with 1.12% in early 2000. The 15% tax rate on most dividends is a nice bonus, one that Congress isn't likely to change in the near future. "In the past, if you paid a dividend it was almost a sign of weakness that you couldn't find something better to do with the money," says John Buckingham, manager of the Al Frank Dividend Value Fund. "There has certainly been an increase in the desire to

'tis the season to enjoy something unusual.

Strawberry Jive

INGREDIENTS

2 oz. Hendrick's Gin
2 basil leaves
4 mint leaves and a mint sprig
2 strawberries
¾ oz. simple syrup
a couple dashes fresh lemon juice
1 oz. fresh orange juice

PREPARATION

Muddle the mint, strawberries and basil leaves in the bottom of a mixing glass with the syrup. Add the remaining ingredients except the mint sprig garnish and shake well with ice. Strain into an ice-filled rocks glass. Garnish with mint sprig.

HENDRICK'S
DISTILLED and BOTTLED IN SCOTLAND
GIN

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The Big Pictu

reward shareholders with dividends

You can find nice dividends in pr cally any sector of the market. The u suspects—financials, pharmaceuti and utilities—offer some of the fat Large money center and superregi banks, which have underperfor their smaller, localized brethren, a nice combination of a value price a regular dividend check. At a re price of 35.50, Wells Fargo & Co. a reasonable price-to-earnings rat 14 and a solid dividend yield of 3. U.S. Bancorp, which is consider potential takeover candidate, curr yields 3.88%.

MANY DRUG STOCKS YIELD around But investors with a bit more toler for risk might consider Pfizer Inc.'s idend yield, which is closer to 4%. its potential for price appreciatior ter the pharmaceutical company p a major drug from its pipeline stock took a hit, falling from 28 to mid-December. Pfizer, with a p-e of 12, is cheaper than it has been the Hillary Clinton health-care i tive more than a decade ago. Cor ians figure that Pfizer's p-e shou closer to 17 once its gets through bad patch, pushing the stock up t In the meantime, says Bart Geer o nam Equity Income Fund, "inve are being paid to look over a valle

One surprising place to find dends is technology companies, v also offer the lure of strong gr potential. Mega-cap names suc Microsoft Corp. and Intel Corp fer puny payouts. But small, cash companies have been rewarding shareholders handsomely. Online marketer Traffix Inc. has a 6.05% while memory-chip maker Dat Corp. yields 5.7%. In the telecom a Verizon Communications Inc.'s recently hit 4.54%. Of course, aren't your usual stodgy dividen ers; high tech comes with high ris

For a basket of diversified div payers, the best way to go is a change-traded fund (ETF) or a m fund. The iShares Dow Jones Dividend Index, which owns mor 100 of the market's top payers, recent yield of 3.1%. Thornburg I ment Income Builder Fund has 4 its money overseas, where divi tend to be fatter than in the U.S fund's yield is a lip-smacking 3 In today's perplexing income en ment, that's a big difference.

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RETIREE Joe De Cola wants to indulge his wanderlust while preserving his capital

Expert Advice for Real-Life Finances

We match four investors at different stages of life with financial advisers for some sound advice. BY LAUREN YOUNG

THIS IS THE TIME OF YEAR WHEN investment advice flies at you from every direction. Apparel maker Under Armour "is a buy to the ninth power!" shrieks Jim Cramer, the over-adrenalized star of CNBC's *Mad Money*. Bank of America's strategists are talking up health care and consumer staples as two key places to invest in 2007. Meanwhile, Jim Rogers, author of *The Investment Biker*, says the smart money is on commodities, which, unlike stocks, "cannot go to zero."

Whew. These are great ideas...for someone, but maybe not for you. So how can you funnel the barrage of hot stock tips and smart investment strategies into practical advice? To find out, *Business-Week* asked a team of financial advi to review the portfolios of some different kinds of investors and m recommendations.

The advisers were given key det about the investors, including the v and allocation of their retirement taxable accounts, cash holdings, and nual income, as well as special finar concerns and goals for the year ah While a face-to-face encounter m yield other advice, these action p show how investment advisers add real-world questions.

JOE DE COLA The former *Today S* producer, 69, gives new meaning to word "peripatetic." After retiring f General Electric in 2003, he ran stra to the airport. In the past 12 months has spent weeks at a time in Amsterd Palm Springs, Mexico, and Croati coli outbreaks? The breakup of Bri and K-Fed? Those are of no con to De Cola; he has been busy sip caipirinhas in Brazil for the past mo "I want to see as many places and d many things as possible while I'm healthy," says De Cola, who is divo No wonder the electronic signatur his e-mail is the W.B. Yeats poem *Song of Wandering Aengus*.

How does he pay for this? So fa has relied on his generous General tric pension ($3,600 per month) as as Social Security ($1,300 per mo He hasn't had to dip into investm yet, but wants to make sure his is safe for the day when he may it—and still have some left over fo four grown children and their kids.

De Cola is sitting on plenty of considering he doesn't need it for l expenses. He has $550,000 in a ta brokerage account, two-thirds of v is AAA-rated floating-rate notes that every seven days, and now yield 5.13%. Sometime in the next yea Cola hopes to sell his vacation in San Miguel de Allende, Mexic $500,000—which should bring in more cash.

That's too much cash in one ki investment, says Lisa Cremonini, tified financial planner at Jane Sie Associates in Natick, Mass. Her a "Create buckets of cash to diversify holdings." Cremonini recommend

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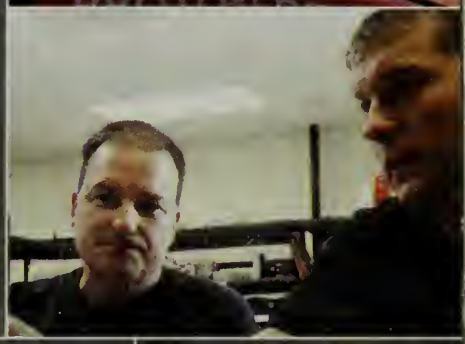

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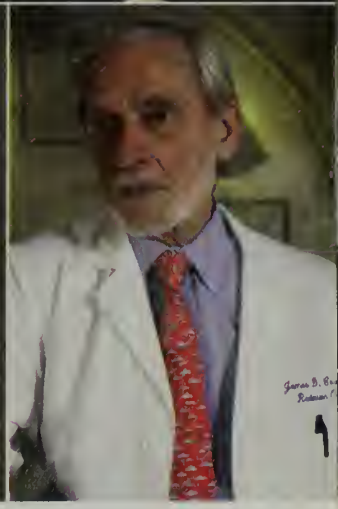

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DON'T MISS IT FOR THE WORLD

FAMILY MAN David Patterson balances savings for college and retirement

la put the money into insured cer- es of deposit from different banks, ing maturities of 3 to 18 months. will ensure a CD matures every 90 or so, instead of every seven days for otes he uses now. Using the longer- CDs, she estimates, De Cola could about one-quarter percentage point A good place to find high-yield CDs nkrate.com. While he's spreading sh around, Cremonini also suggests bank account, which will be useful wanderlust takes him back to the nent (page 100). "Given how low llar is right now, it's a good idea to me money abroad," she says.

Cola's retirement account doesn't much work. Cremonini likes the ment mix (48% equities, 40% fixed e, and 12% cash), although moving ut of cash and into international state and reallocating some fixed e to foreign bonds would make it etter diversified. Cremonini sug- ncluding funds like Cohen & Steers ational Realty and the Templeton Bond Fund.

PATTERSON One at David Patter- ortfolio, and you ll the DesMoines of three is a saver planner. A mar- communications ger at Deere & Co., Patterson has accounts at Smith Barney and Ameriprise Financial and a sizable retirement account at his employer. He's now paying for most of his son's college, and he contributes to the State of Iowa 529 College savings plan to fund his youngest daughter's college education. (The older daughter is finished with college.) Patterson, 50, has paid off most of the mortgage on his home and makes the maximum contributions allowed by law to his retirement plan.

Even so, Patterson faces a few financial dilemmas in 2007: He has built up a stash of John Deere stock options, potentially a five-figure sum, and he's not sure if it makes sense to exercise them, especially if his bonus is significant. "I don't want to create a taxable event," he says. In addition, Patterson is trying to figure out how much money he and his wife, Dawn, a part-time pediatrics nurse, should add to the $27,000 college savings account they have amassed for their youngest daughter, Nickie. She will be college-bound in two years and might be eligible for academic scholarships, so Patterson doesn't want to overfund the account.

Because John Deere stock is near an all-time high, adviser John Merrill of Tanglewood Capital Management in Houston, says Patterson should sell his options as soon as possible and diversify the proceeds. "Whenever you exercise options, you're going to pay tax," Merrill says. "I'd rather pay more tax if it means I exercised at a higher price." If Patterson is tax-averse, he

Nearly all advisers plug some foreign investments

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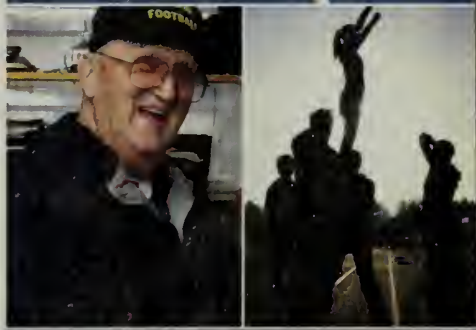

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RETIRING AT 55 is Rick Spickelmier's goal, if he can play his cards right

lif.) Zip Code. Rick Spickelmier might look like a hippie, but he has the nest egg of a yuppie.

Spickelmier, 47, is the chief technology officer at a software startup, and he has socked away about $230,000 in retirement accounts, as well $200,000 in taxable accounts and cash. His home is valued at $600,000. Let's just say that with an annual income of more than $150,000 and big annual bonus potential, Spickelmier can afford to wear tailor-made tie-dyes.

But Spickelmier, who is single, has a lofty goal. He wants to retire at 55, and to do that, adviser Susie Johnston of Cherry Hills Investment Advisors in Littleton, Colo., thinks he needs to make some changes. His retirement account is currently split between two T. Rowe Price Retirement Funds—2015 and 2020. (In these target-maturity funds, the asset mix changes as you get closer to retirement.) "These low-maintenance funds are appropriate for people who don't want to pay attention to their investments, but there are better options," Johnston says.

His other problem is now familiar—he doesn't have enough foreign exposure. Johnston recommends fixing that with a 5% allocation to Dodge & Cox International Fund. While that's the only purely overseas portfolio, the other funds she recommends all have some portion of their assets abroad. They include Third Avenue Value and Fairholme funds, which focus on cheap or out-of-favor stocks, and Loomis Sayles Bond Fund.

In Spickelmier's taxable account, Johnston thinks exchange-traded funds (ETFs) are better vehicles than mutual funds because of their low expenses. She also recommends ETFs (as well as municipal bond funds) because they're more tax-efficient. Because Spickelmier has no international holdings in his taxable account, she suggests a 20% stake in a diversified international ETF.

Right now, Spickelmier is putting an extra $400 toward his $2,400 monthly

ut the money in a municipal bond which at least will protect the earn- m future taxes.

r the college savings, Merrill thinks on should contribute $5,000 in 07 to get a state tax deduction, but he hold off on any additional contri- s. "He can earmark those assets his retirement," says Merrill, who sh on large-cap stocks in general Marsico 21st Century and Jensen o funds in particular. "If you are o have a little spice in your portfo- is the time," Merrill says.

rson also needs to ratchet up ernational investments, both in irement and taxable accounts. rr, who is high on international s, says Patterson should have 33% abroad, rather than the 12% s. Merrill suggests funds such as eBernstein International Value, & Cox International, and Janus s.

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NEW FAMILY Linsay and Ryan Shirley are living on one income for the time being

age payment, with the goal of get- g significant portion of the house ic ff by the time he retires. But John- r ays he would be better off investing e oney, because the interest on his o age is just 5.625%.

SY SHIRLEY Six months ago, Lin- y irley left her lucrative position as so ware consultant for a new posi- n nother to Jaidyn. Ryan, Linsay's st nd, a certified public account, is w e sole breadwinner. The loss of e ncome means that the Shirleys, th 0, are making some sacrifices—in- id g dinners out (as if there's time th new baby). The Shirleys, who live H ghlands Ranch, Colo., a Denver bu , have about $40,000 in retire- en ccounts, as well as a cash cushion $3,000.

Lo ding ahead to the next year, the un couple wonder whether they should st ving for Jaidyn's le education. Ryan, o expects to earn 0,0 0 to $90,000 xt ar, also wants to gi n MBA program ni t. Ryan hopes his r er will pony up e of the tuition, till expects to pay the bill, which t an even bigger their finances.

David Brady, president of Brady Investment Counsel in Chicago, says the Shirleys shouldn't stress out about college savings. "I'm a big fan of keeping things as flexible as possible," Brady says. He prefers they focus on paying down their mortgage, and bulking up on their retirements accounts. Although Ryan doesn't have as much flexibility in his company's retirement plan, Brady says Linsay should "get as aggressive as possible" with hers. She should tilt her rollover IRA to a mix of ETFs—iShares S&P 500 Growth Index ETF (50%), iShares S&P 500 Index (30%), Wisdom Tree SmallCap Dividend (10%), as well as a mutual fund, Vanguard Developed Markets Index Fund (10%).

The Shirleys also have about $12,000 in taxable accounts, with positions in two stocks, Comcast and Level 3 Communications. Brady recommends adding 100 shares of Chipotle Mexican Grill Inc. "This is great growth stock for a young family starting out," he says.

Linsay might begin part-time consulting work (which means an expected $2,000 per month), and any additional cash should be directed to technology and health-care investments, Brady says. His two choices are both ETFs as well: Vanguard Health Care and Vanguard Information Technology. "These two sectors have among the worst performances in 2006 but are expected to be among the best in 2007," he notes. We'll know this time next year. ■

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THE ALMIGHTY EURO? The declining dollar's biggest competitor

Don't Let the Dollar Get You Down

The greenback will probably stay anemic, but new ETFs and other instruments offer protection. BY LEWIS BRAHAM

THE EURO AND OTHER CURRENcies have trounced the U.S. dollar since 2002, and the trend is likely to persist into 2007, perhaps longer. The reason: Massive U.S. trade deficits—$586 billion in the first nine months of 2006 alone—mean we're flooding the globe with more dollars than foreigners want to hold. With no end in sight to the trade deficit or the U.S. budget deficit, the greenback should be under pressure for years.

Whether you want to protect your wealth in a global sell-off or profit from the shrinking dollar, there are new ways to do it. In recent months, eight currency-based exchange-traded funds (ETFs) have been launched, making currency investing as easy as buying and selling stocks. Also, there are now eight currency-focused mutual funds vs. just two five years ago. Go online and you can open bank currency accounts.

As a hedge against the beleaguered greenback, the euro is probably your best bet. "If the dollar will decline, it will decline against its major trading partners' currencies—the euro and the yen," says Frank O. Trotter, president of EverBank Direct, an online bank deals in 25 currencies. The euro ma the better play for now, though Jap financial picture is improving (see p. "The euro is establishing itself as a w reserve currency in competition with dollar, and many countries are lool to sell their dollars and buy into it," David Reilly, Rydex Investments' dire of portfolio strategies. "China's cer bank has over $1 trillion it wants tc versify, so it's moving into euros."

To buy euros, you could purcl Rydex' Currency Shares Euro Trust ETF, or open a euro-denominated th month CD at everbank.com. But the yields 2.6% to the CD's 2% and doc lock up your money.

ALTHOUGH THE EURO SHOULD a good long-term performer, it gained more than 50% against the lar since its low in 2002 and may off in the short run. Michael Ha stab, manager of the Franklin Tem ton Hard Currency Fund, thinks Swedish krona and Polish zloty strengthen because of trade surpl and productivity growth. But he's a fan of more speculative plays in "We added the yen for the first tin five years," he says. "Japan's ban sector and consumer spending are proving, and it looks like interest will rise." He also favors Singa Korea, and Thailan

If you're unce which currency to stick with a diver fund like Hasens which has been ar for 17 years. N funds such as Merk Currency and Pru Global Income curr avoid most eme markets and even J Both favor the eur Swiss franc, and They are also buyin currencies of No and Canada, wher mand for oil and ral resources has l trade surpluses. It mirror image of w happening with greenback.

BETTING AGAINST THE GREENBACK

CURRENCYSHARES (SYMBOL)	PRICE*	YIELD*
CANADIAN DOLLAR (FXC)	87.11	3.38%
EURO (FXE)	132.14	2.52
SWEDISH KRONA (FXS)	145.69	1.93
MUTUAL FUNDS (SYMBOL)		TOTAL RETURN**
FRANKLIN TEMPLETON HARD CURRENCY (ICPHX)		9.29%
MERK HARD CURRENCY (MERKX)		11.68
PRUDENT GLOBAL INCOME (PSAFX)		13.66
EVERBANK CURRENCY ACCOUNTS		YIELD*
EURO 3-MONTH CD		2.02%
NORWEGIAN KRONE 3-MONTH CD		1.88
THAI BAHT 3-MONTH CD		4.06

Data: Rydex Investments, EverBank. *Dec. 8. **Appreciation plus reinvestment in dividends and capital gains, Dec. 31, 2005-Dec. 8.

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It's the Large Caps' Turn to Shine

Forecasts of a slower-growing economy have more money managers thinking big. BY LAUREN YOUNG

THE MUTUAL FUNDS THAT GET talked about at cocktail parties are usually the small, singular sensations that deliver the sexiest returns. But the bulk of the money still resides in the big-stock funds that have been lagging behind small-company offerings for the past six years.

Finally, though, the millions of investors with billions of dollars in large funds had something to crow about at their holiday get-togethers. Large-cap value funds have gained ground since late spring and are now only one percentage point behind small-cap value funds for the year: 17%, vs. 16% total return (through Dec. 8). Other large-company funds are also catching up with their small-cap counterparts. "This is not a head fake," says Mark Keller, chief investment officer for Gallatin Asset Management, the fund management arm of A.G. Edwards Inc.

We've heard about large-cap comebacks before. In fact, this time last year, Keller's line was a common refrain. But now that the economy has slowed markedly, there's a better chance that larger companies might finally maintain their edge. "Higher-quality, higher-capitalization companies are the safest place to be if the U.S. economy is heading for a soft landing," says Bob Doll, vice-chairman and chief investment officer for equities at money manager BlackRock Inc. Doll, who is in the soft-landing camp, is further tilting his portfolio to large-cap growth stocks.

With the Dow Jones industrial average and the Standard & Poor's 500-stock index on high ground, you may not think big stocks are cheap, but they are. That's because this is the first bull market in 45 years where the price-earnings ratio of the S&P 500 has contracted, says John Carey, portfolio manager at the $7.7 billion Pioneer Fund as well as the $1.1 Pioneer Equity Income Fund. In 2002, the typical S&P 500 stock traded at 17 times the next year's earnings. Today the forward p-e is 15. That m blue-chip stocks are moderately p and have room to run.

You can tell large-company st have some momentum by lookin the folks who are lining up to buy t Just peek under the hood of "all- mutual funds, the kind that are fr buy any size stock the manager de and you'll find that the focus is on ger companies. At Hodges Fund, of the $570 million portfolio is inv in large-cap stocks such as Apple puter, ConocoPhillips, Cisco, Wal- and Caterpillar. That's up from a 45% a year ago.

CO-MANAGER DON HODGES BUYS a pany when it sports a strong ba sheet, good revenue growth, and a s stock price. In the past nine m some of the blue chips that passe hurdle are General Electric and Cola. "These are stocks I've never o before," Hodges says. "They haven't much for six years, but they quit down." He's also added Halliburto to the fund because "as long as oil above $40 per barrel, you are goi have a lot of drilling activity."

Mark Coffelt, manager of the $7 lion Texas Capital Value & Growth also thinks big is better. In the pas months he has shifted half of his go where fund from small-cap and mi names into big global equities, incl the ADRs of Sanofi-Aventis, Diage ABN-AMRO. "These companies h big global footprint," Coffelt says.

ABN-AMRO, for example, is ga

THE GIANT EQUITY FUNDS

FUND	ASSETS (BILLIONS)	1 RE
GROWTH FUND OF AMERICA (A)	81.8	1
INVESTMENT COMPANY OF AMERICA A	73.1	1
VANGUARD 500 INDEX INV.	71.4	1
FIDELITY CONTRAFUND	67.1	1
WASHINGTON MUTUAL INVESTORS A	67.0	1
STANDARD & POOR'S DEP. RECEIPTS	65.2	1
DODGE & COX STOCK	63.8	1
CAPITAL INCOME BUILDER A	58.4	1
CAPITAL WORLD GROWTH & INCOME A	57.9	1
INCOME FUND OF AMERICA A	57.6	

*Appreciation plus reinvestment of dividends and capital gains before taxes, Dec. through Dec. 8, 2006

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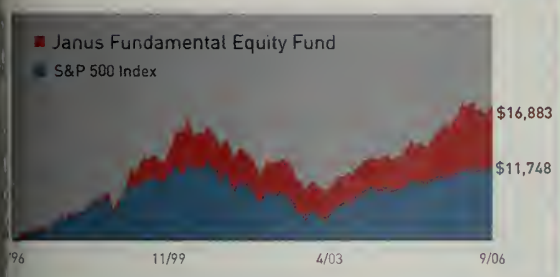

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market share in India and China, two of the hottest emerging markets. Yet the company's stock is trading at a mere 12 times 2007 earnings. "That's cheap for a bank," Coffelt says. The Manning & Napier Equity fund, which also has an all-cap mandate, is finding the best opportunities in bigger stocks, too. The fund's managers aren't concerned about where a company is domiciled. They point to the fact that 26% of the companies in the S&P 500 derive most of their revenues from outside the U.S. Take Coke: It gets 71% of net operating revenue outside North America, says George H. Stamey, a Manning & Napier managing director. "The distinction between U.S. and non-U.S. is not meaningful," Stamey says.

EVEN THE BIG-CAP FUNDS are getting more mega in scope. The Chase Growth Fund always focused on larger companies, but the market cap of stocks in its portfolio jumped from $20 billion to $95 billion in the past six months. Lead manager David Scott, who uses quantitative screens to initially identify good prospects, recently upped the fund's exposure to large pharmaceutical companies such as Johnson & Johnson because of better earnings prospects.

Overall, fund investors will be pleased when they look over their 2006 yearend account statements. Although U.S. equity funds as a whole failed to outpace the 15% total return of the S&P 500 in 2006, they came close, with 13%. The best performance came from overseas funds, bolstered by strong markets and a weak dollar that made non-dollar holdings more valuable for U.S. investors. Diversified international funds earned 22%, while Latin America funds soared 40%, making Latin American equities the best-performing fund category for the second year. Pacific/Asia funds (excluding Japan) also jumped 34%. The only losses among any category came from Japan funds, which dropped 4%.

Thanks to the potent performance of foreign funds as well as strong inflows, mutual fund assets hit an important milestone in 2006: They passed the $10 trillion mark for the first time, according to the Investment Company Institute, the fund industry's trade group.

Precious metals (read: gold) funds rose 33%, extending a rally that began back in 2001 when gold traded at just $260 per ounce. After peaking at $730 per ounce in May, gold finished 2006 trading around $628 per ounce. Investors continue to pour money into the iShares Comex Gold Trust ETF, and expected to drive gold prices high 2007. "The ETF holds almost 600 t gold," notes John Hathaway, mana the Tocqueville Gold fund. "That r it larger than a lot of the central ba Most precious metals funds, howeve

STOCK FUNDS

CATEGORY	T RE
LATIN AMERICA	3
PACIFIC/ASIA EX-JAPAN	3
REAL ESTATE	3
PRECIOUS METALS	3
EUROPE	3
DIVERSIFIED EMERGING MKTS.	2
UTILITIES	2
FOREIGN	2
COMMUNICATIONS	2
WORLD	1
NATURAL RESOURCES	
SMALL-CAP VALUE	
LARGE-CAP VALUE	1
MID-CAP VALUE	1
FINANCIAL	1
DIVERSIFIED PACIFIC/ASIA	1
INTERNATIONAL HYBRID	1
SMALL-CAP BLEND	1
LARGE-CAP BLEND	1
ALL CAP	
SMALL-CAP GROWTH	
MID-CAP BLEND	
MISCELLANEOUS	
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MID-CAP GROWTH	
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INTL. EQUITY FUND AVERAGE	
S&P 500 W/DIV	
ALL EQUITY AVERAGE	
U.S. DIVERSIFIED FUNDS	

*Appreciation plus reinvestment of dividends and capital before taxes, Dec. 31, 2005, through Dec. 8, 2006
Data: Standard & Poor's

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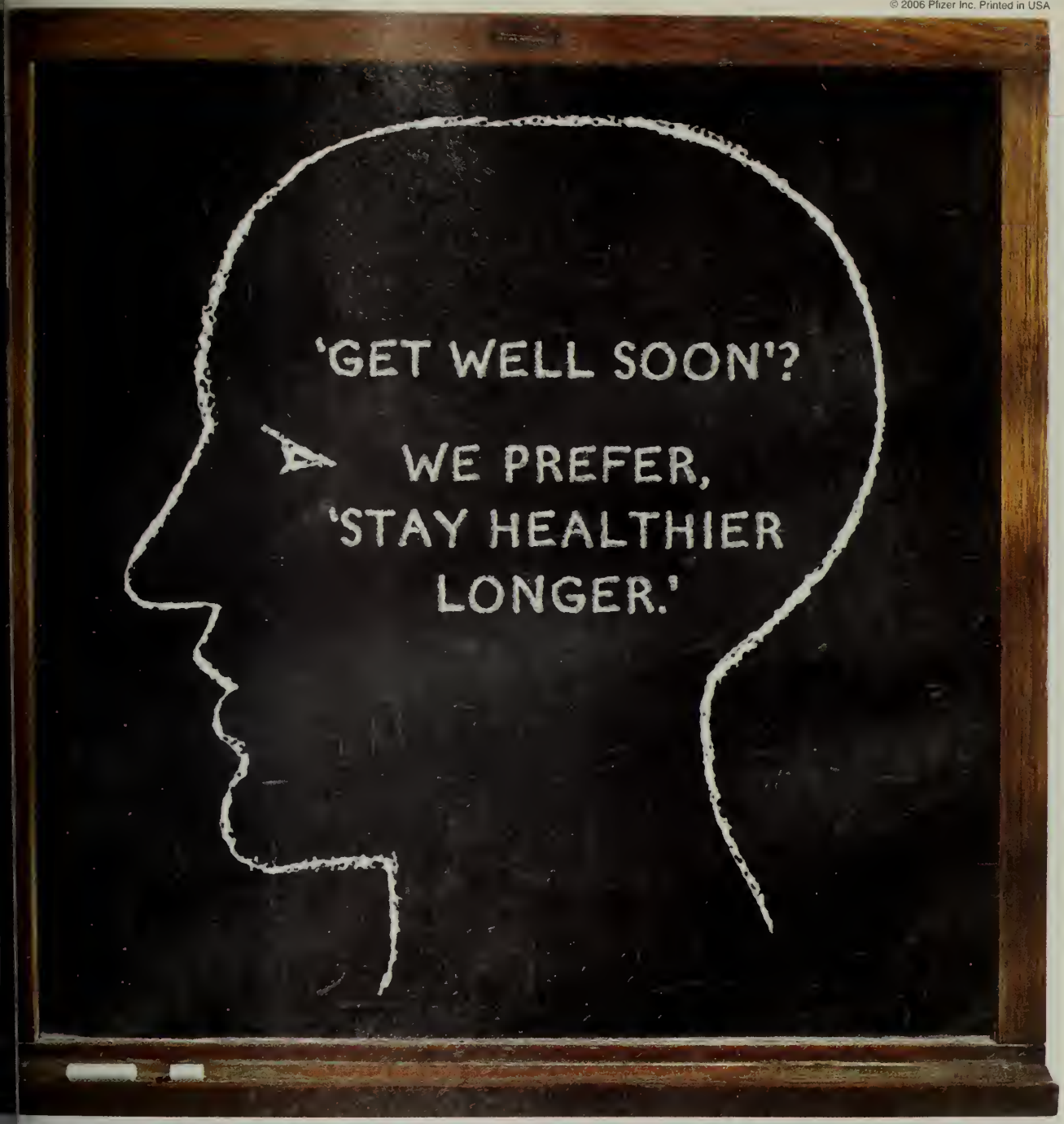

nk of it. Americans are living longer and spend- more on healthcare. In fact, spending has risen to re than two trillion dollars a year. At Pfizer we're rking on ways to help - with innovative medicines t it help prevent illnesses and reduce the cost of ating them. We also have programs that provide our dicines to people without prescription coverage.

t we know we have to go further. Across America, zer is partnering with health care providers, state vernments and local communities to bring personal- d, quality, preventive health solutions to patients; asures like providing personal care managers, 2 hour-a-day nurse call centers, and health education such as diabetes workshops and other group health classes. And the results are clear. These programs are helping keep people healthy and reducing the economic burden of disease, in some cases decreasing hospital stays by as much as 52%.

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Nina Garcia
Fashion Director, ELLE Magazine

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ining stocks instead of gold bars. rl Malan, co-manager of Van Eck ational Investors Gold Fund, says so will continue to glitter in 2007 if S. dollar continues to lose ground, ny analysts expect. "There's an correlation between gold and S. dollar," Malan says. Another gold prices will continue to climb use the Chinese, Russian, Indian, erman central banks are expected more of their reserves from U.S. into gold, he notes. "In next 12 s gold can do very well," Malan is prediction: Gold will close 2007) per ounce.

ID FUNDS

Y	TOTAL RETURN*
RTIBLES	10.76%
ING MARKETS BOND	10.74
IELD	8.76
HIGH-YIELD	7.22
ECTOR	7.21
ATIONAL BOND	6.33
NEW YORK LONG	5.16
NATIONAL LONG	5.00
CALIF. LONG	4.79
SINGLE-STATE LONG	4.74
GENERAL)	4.51
EDIATE (GENERAL)	4.40
EW YORK INTERM.	4.32
(GENERAL)	4.27
ALIF. INTERM.	4.18
INGLE-STATE INTERM.	4.16
HORT	4.15
E MONEY MARKET	3.99
ATIONAL INTERM.	3.95
GOVERNMENT	3.93
EDIATE GOVERNMENT	3.72
HORT	2.90
E MONEY MARKET	2.60
OVERNMENT	2.52
E BOND AVERAGE	5.42
D AVERAGE	5.03
ABLE BOND AVERAGE	4.51

n plus reinvestment of dividends and capital gain Dec. 31, 2005, through Dec. 8, 2006 rd & Poor's

The outlook for bond funds, however, is more boring than bright. Fund managers expect interest rates as well as inflation to remain low, and the flat yield curve isn't expected to budge very much.

THAT'S WHY THE CO-MANAGER of two Loomis Sayles funds, Kathleen C. Gaffney, has shifted 40% of her Bond and Multisector Bond funds overseas. She gushes about the 8.5% yields for investment-grade Mexican government debt. "If you were going to look for 8.5% yields in the U.S., you'd be looking in the junk-bond market," Gaffney says. And while there's a risk that a falling peso could make Mexican debt less sweet, she doesn't foresee the peso weakening in 2007.

Municipal bond funds provide good opportunity, too. That's because short and intermediate muni bonds are sporting attractive yields. Munis also have lower default rates than corporate bonds. That said, the supply of new bonds is slim. Most municipalities are in good financial shape thanks to tax revenues, so new issuance was down about 10% in 2006. It's not expected to rise in 2007, says Tom Spalding, a senior portfolio manager at Nuveen Investments. But some states, such as Texas and Nevada, are still coming to market to finance lots of high-quality infrastructure projects, Spalding notes.

Corporate bond investors may face a rocky year. Although recession is always a risk, few corporate bond managers think one is imminent. The real wrench in the corporate market, they say, is the private equity boom. To orchestrate leveraged buyouts, private equity companies force their takeover targets to issue debt. That can result in a credit downgrade, which drives down the market value of the bonds. "What is an opportunity on the equity side is a risk on the fixed-income side," says Mark S. Jordahl, chief investment officer at First American Funds.

Even worse, the new debt that's issued often puts existing corporate bondholders in a subordinate position, which means they're more likely to lose out if the company goes bankrupt. What's a corporate bond manager to do? "It's best to hide out in a larger company," says Carl W. Pappo, lead manager of Columbia Income fund. So far, no megacap companies have been leveraged up. Corporate bond funds, and the people who invest in them, might want to take a page from the equity market and think big. ■

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When to Dump A Stock

Four ways to tell if it's time to unload a past-its-prime stock—however painful that may be. BY ROBEN FARZAD

BROKERAGE HOUSES MAKE A living telling people which stocks they should buy. Selling, however, is a whole other matter. With little guidance from brokers—much less business magazines—investors tend to hang on to broken stocks much the same way a jilted lover keeps playing an old mix tape.

It's not easy for an investor to turn the page, but developing sell discipline is essential. "It's about removing the emotion," says Don Kukla, a principal at St. Louis financial planners Moneta Group LLC. "You need to appeal to logic to overcome that emotion."

Logic backed by a little bit of knowledge, that is. There are four telltale signs that it's time to sell a stock—any stock, regardless of its onetime appeal. Investors who follow these strictures can greatly limit their investing heartbreak.

Start with traditional fundamenta revenue, earnings, and all the multip and ratios that go with them. Ther just no ignoring them. The fact t General Motors Corp. shares have cently doubled—albeit from a 24-y low—might convince investors that back in the high life. The company s it's continuing this momentum by sla ing its crippling structural costs. G auto operations posted an adjusted loss of $116 million in the latest qu ter—no cause for celebration, but a $ billion improvement over last year. A the company seems ready to invest innovation, with management hav just announced plans to make GM first automaker to commit to producin plug-in hybrid car.

But that doesn't change the fact t GM remains a financial basket case. all its cost-cutting progress, it is rapidly burning through cash, essenti drawing down on its savings to pay current bills. Lackluster vehicle sales continued market share losses to Toy Motor Corp. contributed to GM's nega free cash flow of $5 billion in the la quarter. That stat sho dampen most of the thusiasm for the com ny's shrinking $20.4 lion cash balance. (G more than $30 bil in debt should dam the rest.)

"IT'S A STORY OF m sive pension and ur costs, huge competit and declining ma share," says Pat Do director of stock an sis at Chicago-based vestment research Morningstar Inc. an awful business is overvalued." E worse, he says, sh holders will be the last to get their hand any profit the comp might eke out. "Are really going to tell that the unions and tirees aren't going t to grab it?" he asks, ing that GM's pen and benefit liabil eclipse its equity va The stock traded cently at $30. "Get c says Dorsey. "It's w

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$15." Another cue: Billionaire Kirk Kerkorian, the activist investor who used his 10% GM position to agitate for the cost cuts that boosted the stock, just dumped the last of his shares.

Rule No. 2: Always examine nontraditional valuation readings. Ivan Feinseth of Matrix Investment Research uses return-on-capital measures to spot problems, an approach that has helped him trounce the market the past two years. Definitions differ; Feinseth considers return on capital to be a company's net operating profit after taxes, divided by capital. It shows how well a company uses shareholder money.

Consider outdoor retailer Cabela's Inc. Between 2003 and 2006, the company boosted sales by 36% and profits by 46%. The problem: Cabela's is spending so much to expand its store count that it has cut its return on capital in half during the past three years. "On the surface," he says, "Cabela's growth story is powerful. But peel back a layer and you'll realize they are not making shareholders real money." Feinseth calculates that Cabela's "economic value added"—the amount by which its earnings exceed or fall short of the minimum rate of return that shareholders could have received elsewhere—has fallen from $43 million in 2003 to −$16 million today. The new stores, he says, are churning out diminishing returns for shareholders. "They would have to tremendously increase profit margins just to fit into all their new overhead," he says. Feinseth worries, too, about the company's plans to open more stores in the next 12 months than it has in the past two years, despite the fact that its most profitable sales come from catalog and Internet operations. With shares near a 52-week high, Feinseth urges investors to bail.

It's also important to pay attention to what bond analysts are saying. After all, bondholders are their target audience—and these creditors get priority over shareholders if a company has to liquidate its assets. Credit analysts are keenly alert to cash-flow and balance sheet trends that very often ripple into a company's stock price. "You can play with earnings," says analyst Shelly Lombard of Gimme Credit LLC, a New York capital structure research firm. "But things like operating cash flow and the balance sheet generally don't lie."

LOMBARD THINKS shareholders of auto parts maker American Axle & Manufacturing Inc. should heed her warning that the company is an "ax-cident waiting to happen." In October, Axle, a major GM supplier, posted its first quarterly loss in its seven-year history as a publicly traded company. Even as sales and production volume have plunged, shareholders have kept the stock afloat largely on hopes of improved cost-cutting and a sustained GM turnaround. Lombard thinks they are overlooking the fact that Axle is living on borrowed time, drawing from a $600 million revolving credit line just to make ends meet. Its net operating cash flow of −$25.5 million in the latest quarter plunged from $8.6 million last year. "It's not a susta able capital structu Lombard says. "Ever ally the cash is going run out." If that happe her bondholding clie will still get a piece of remaining assets. Sh holders likely won't.

Last, investors sho always think like c trarians. Wall Street a lysts tend to act in r son, upgrading stocks masse after good n and downgrading a shares have already en. Having a contra sell discipline—trimm while they are pror ing—lets you cash into strength.

Todd Salamone Schaeffer's Investment Research Inc. gests going against the resurgenc bullishness for Microsoft Corp, wh shares have soared 37% since June May, Salamone says, 53% of analysts covered Microsoft were recommen it; that figure is now up to 70%. Salam thinks back to 2004, when there was r unanimous bullishness for Microsoft. stock would ultimately lose more 2% for the year while the NASDAQ ga nearly 9%. "A lot of hope is being into the stock again," he says, "and wouldn't want to buy high expectatio Salamone says the optimism surroun the release of Microsoft's Vista opera system is overrated and, in any event already reflected in the share price.

The company, once a highflier, mains mired in a prolonged, often markdown of its earnings multipl investors come to terms with a r sedentary Microsoft. Salamone say bearishness is also buttressed by Ms soft's unusually low amount of sh selling activity. Short-sellers bet the share price will go down. Right just 2.5 times the average daily vol is represented by so-called short in est. That's down sharply from its peak of 3.8 times and a full point lo than NASDAQ's current short int ratio. That tells Salamone there just enough skepticism toward the stock would rather unload Microsoft sh now than wait until a change in s ment marks them lower. "You hav be careful about getting into one-d tional bullishness," he says. "The people in a room, the more need to for the exits." ■

Credit analysts may have insights into the stock price that other investors lack

PLAYBOOK: BEST-PRACTICE IDEAS

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WALL STREET HYPE
Stock analysts often travel in packs. Be skeptical of too much optimism; the same people were telling you to sell when shares were worth buying.

BEARISH BOND ANALYSTS
They're paid to pick up on financial troubles that might affect creditors. Follow their cues closely; when they raise concerns, heed them.

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Transforming IT Management

RIVERSIDE, CALIF. Banks are being required to toughen their standards

Curb Your Enthusiasm About a Recovery

Home prices still have room to decline, and it may take 15 years or more to reach new inflation-adjusted highs. BY PETER COY

HOUSING BOOMS ARE SHORT and exciting. Housing busts, on the other hand, are long and painful. So don't put much faith in those oft-heard assertions that the worst is already over. Prices are likely to fall further in many markets in 2007. In some others, prices may rise, but at less than the rate of inflation. A *BusinessWeek* analysis of the past three decades shows that if history repeats itself, it's likely to take 15 years or more for many parts of the country to get back to their inflation-adjusted peaks.

For residential real estate, the outlook for 2007 ranges from mildly positive to awful. The major markets that do least badly will be "revenge of the nerds" cities like Dallas and Houston that the boom bypassed. Even if all they generate is low-single-digit price gains, they will look good by comparison. Seattle and Raleigh, N.C., with healthy job growth, should also do O.K. The biggest losers will fall into one of these groups: cities like Detroit that are suffering economic contractions; cities like Los Angeles, San Diego, and others in California where prices are extraordinarily high and have barely begun to adjust; and cities like Miami, Las Vegas, and Phoenix that have a huge overhang of unsold houses or condos.

Advice to homeowners: If you need to sell and you're not getting much interest, cut the price by an extreme amount. If you make halfhearted cuts, you'll remain overpriced and you'll follow the market all the way to the bottom. Advice to buyers: Bargain hard. Many sellers are still asking for too much. "As tough as our market's been, the toughest thing is to get sellers to understand that prices aren't going up 18% to 20% a year anymore," says Ned Redpath, head of Coldwell Banker Redpath & Co. Realtors in Hanover, N.H.

In some ways, a story on housing doesn't even belong in the Investment Outlook issue, because regular f shouldn't be taking a one-year pers tive on the places they live. If you n need to know what prices are goin be doing, say, six months from no probably means you've worked you into some kind of corner. For the term, housing is still a good bet for homeowners because in addition to capital gain, it provides a unique an dividend: a roof over your head.

THAT SAID, RIGHT NOW is not the time to buy or move up, even with th cent price declines. The inventory o isting homes shot up 34% from Oct 2005, to October, 2006, and now st at nine months' worth of condos seven months' worth of single-fa houses at the current rate of sales. backlog will take a long time, and of price-cutting, to clear out. One h ing bear, Ian Shepherdson, chief economist of High Frequency Eco ics in Valhalla, N.Y., guesses that p nationally could fall 5% to 10% fror end of 2006 to the end of 2007, goin the Office of Federal Housing Enter Oversight housing price index. U that same measure, Goldman, Sac Co. predicts a 3% decline from to 2007. Before 2006, the index' performance since its origin in 197 a 0.3% increase in 1990. The OF numbers don't cover the highest- lowest-priced homes, which will ably do even worse, says Econom Chief Economist Mark Zandi.

The Federal Reserve is likely to the market in 2007 by cutting short interest rates, which will make a able-rate mortgages cheaper. Offs that, Zandi notes, is the fact that are being required to toughen their dards for exotic loans such as est-only and option-payment mort That will make it hard for people marginal incomes to buy or refinar

Housing prices were pushed part by get-rich-quick speculation. real estate has lost its grip on the p imagination. Says Richard J. Del chief economist of National City in Cleveland: "We're looking at s years of weak home prices. It'll to the time when no one is talking real estate." Oh, well. You can still flier on Google Inc. ■

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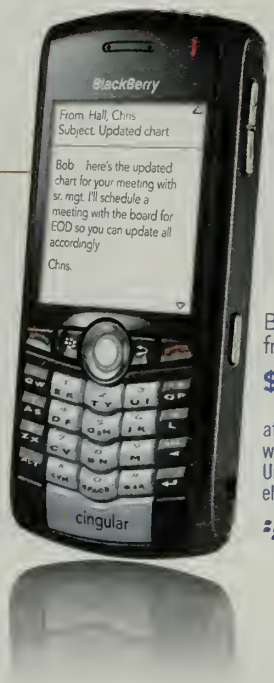

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Art's New Frame Of Reference

India, China, Russia...Collecting is going global, and prices have room to run. BY THANE PETERSON

RETIRED REAL ESTATE INVESTOR Howard Farber had the foresight to start buying contemporary Chinese paintings a decade ago. For years he was alone. Then three years ago prices began to soar. So while everyone else was playing catch-up, Farber also started buying Cuban art, which he thinks is "very undervalued" and deserves attention.

Farber, 64, is out in front of one of the biggest trends in collecting. As the world economy globalizes, the more daring Western art lovers are scouring emerging nations for new work. They favor contemporary art because it doesn't run up against the export restrictions most countries place on historic pieces. Connoisseurs figure the best artists' prices are bound to surge as these nations' economies grow and their newly wealthy elites take up collecting. Moreover, they continue to find artists and niches where prices have room to run. Here's a take on some key markets:

INDIA Although works by early modernists such as Tyeb Mehta, 81, and F.N. Souza, who died in 2002, have topped $1 million, Indian contemporary art doesn't yet have China's cachet. However, New Delhi-born, New York-based hedge fund manager Rajiv Chaudhri predicts that "in 5 or 10 years Indian and Chinese art will end up in the same place" in terms of their valuation in the West. Both he and New Jersey money manager Umesh Gaur are high on Subodh Gupta, 42, whose paintings, sculptures, and installations explore his rural roots and whose prices range from $90,000 to $150,000. Chaudhri also recommends the paintings and digital constructions of Baiju Parthan, 50, which sell for less than $50,000. Check out Indian artists at the online auction house Saffronart.com.

CHAUDHRI Indian art values will one day equal Chinese

RUSSIA The country's nouveau-riche collectors have been driving up prices of the so-called nonconformist artists, who defied Soviet authorities from the early 1950s onward by refusing to paint in the prescribed realist style. On Nov. 27, *Violin at the Cemetery*, a 1969 painting by Oscar Rabine, 78, sold for $331,000, three times the previous record, at the London auction house MacDougall's. Joanna Vickery, a Russian art expert at Sotheby's, believes the boom is "just beginning." Sotheby's planned Feb. 15 sale of recent Russian art in London will feature a good selection, as well as work by younger artists such as sculptor Andrei Filippov, 47, estimated at under $15,000.

POLAND The *artiste du jour* is Piotr lanski, 37, whose photo series *The N* 164 images of actors dressed in mili regalia, topped $1 million at an Oct Phillips de Pury & Co. auction in N York. One reason for the high price is Miami collectors Mera and Donald Ru own a copy of the series (purchased eral years ago at a fraction of that pri These days, the Rubells are buying ar Rafal Bujnowski, 32, for under $18, and Zbigniew Rogalski, also 32, for ur $30,000. Both artists show at Wars Raster Gallery (raster.art.pl).

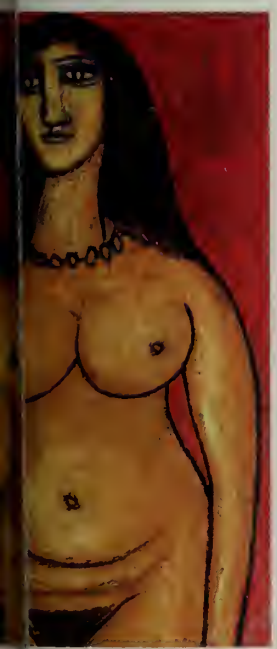
CUBA These artists may get a boost f the expected opening up of Cuba a Fidel Castro's demise. But for now, ban artists such as Armando Mariño, who lives in Spain, have little auction tory and sell for under $12,000. To l about this market, pick up a copy of *Avant-garde: Contemporary Cuban from the Farber Collection* (Harn Mus of Art, $29.95), coming out in Ma Also, Farber's pieces will be feature a show that opens at the Universit Florida at Gainesville on May 29.

CHINA Chinese art is tricky to buy at point. Artprice.com figures that since 1, 2004, the auction price of Chinese temporary art (defined as by artists after 1945) is up 440%, vs. about 44 for the art auction market as a whole big collectors continue to pay up: don's Charles Saatchi laid out $1.5 mi at a Christie's auction in London on 15 for a painting by Zhang Xiaogang,

New work keeps surfacing. O Chinese artists being tracked by (Colo.) collector Kent Logan, six stil for under $30,000. One is Chen ling, 37, whose kitschy sculptures r from $5,000 to $20,000. Another is Junyong, 28, whose take on consu ism in China reminds Logan of artis Koons. Wu Junyong's videos sell fo der $10,000, video stills for $1,400, a Chinese Contemporary Gallery, whi moving from London to New York Jan. 25. For an overview of the Chi scene, check out Mahjong (Hatje C $68) about the pioneering collectio Swiss publishing executive Uli Sigg.

Whether the art comes from Chi elsewhere, emerging-nation collecti here to stay. Henry Howard-Sneyd theby's chief honcho in Hong Kong, "Great art is often produced in perio great patronage, and we're in such riod now." Just keep in mind that int in these markets is frenzied, so it pa be extra careful before you buy. ■

MARINO The value of Cuban art could soar after Fidel Castro's demise



SOUZA A 1961 nude from the early Indian modernist, who died in 2002

ZHANG Charles Saatchi paid $1.5 million for this painting at Christie's in London

Working the Numbers

There's no shortage of info—and no shortage of ways to mine it. BY ROBERT ROSENBERG

YOU CAN BUY STOCKS ON LITTLE MORE THAN a hot tip, and maybe you'll get lucky. But you'll be less dependent on fate if you first back up investment decisions with some scrutiny of the company's financial performance. That's how the Investment Outlook Scoreboard can help you. Made up of 900 stocks drawn from the U.S. markets, the scoreboard, which starts on page 122, is where you can do a quick reality check on that tip, or better yet, discover your own leads. Still, investing by the numbers goes only so far. You also need to follow up with some kick-the-tires research on a company's products, markets, and management before buying shares.

For each stock in the scoreboard, we have a trove of data such as price-to-earnings, price-to-sales, and price-to-cash-flow ratios; past and projected earnings growth rates; dividend yields; and Standard & Poor's Equity Ranking, a letter-grade measure of a company's financial performance. The stocks are also grouped by industry, making it easier to compare, say, computer makers with each other and against an industry average. You can find an interactive version of the scoreboard at BusinessWeek.com.

Where do you start when you have 900 companies and more than 14,000 pieces of information? We've started sorting the data for you, creating eight stock screens that organize the numbers in useful ways. Value investors will appreciate screens that use p-e ratios, price-book value, and dividends to find prospects; growth-oriented investors should find opportunities in the screens based on earnings growth (page 118).

The stocks that popped up in the same screens we ran this time last year appreciated 18.8% on average (Dec. 31, 2005,

TERRY ALLEN

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through Nov. 30, 2006). The comparable numbers for the Dow Jones industrial average, Standard & Poor's 500-stock index, and the NASDAQ Composite Index, were 15.8%, 14.2%, and 9.8%, respectively. In 2004 and 2005, the screens beat the indexes, too. The coming year will be challenging because the market is starting at a higher level, and the economy has slowed.

One of our best performers in 2006 was the "Big Caps to Watch" list, which zooms in on companies with market capitalizations greater than $5 billion and whose earnings are projected to soar next year. This year the list has such stalwarts as Boeing Co., where orders of the company's new 747-8 jet should keep profits aloft, and Eastman Kodak Co., which has redefined itself for the age of digital photography. Not long ago, Wall Street considered Boeing and Eastman Kodak to be flawed companies, but perceptions are changing under new CEOs.

The stocks worth watching aren't always household names. Celgene Corp., a biotechnology outfit, is one. The consensus forecast of Wall Street analysts who follow the company is for earnings to more than double in 2007. Celgene has two patented cancer drugs, and others in the pipeline. Video-game developer Electronic Arts Inc., whose games include Tiger Woods PGA Tour '07 and Fifa '07, also pops up on the list. EA's shares performed poorly in 2006, but analysts believe the release of the hot new Sony PlayStation 3 platform will spark sales as gamers buy new software, leading to a near doubling in earnings per share.

WE LOOK AT TECH stocks in a couple of ways: the stocks expected to have the greatest earnings gains in 2007, and those expected to have the most growth in the next three to five years. Apple Computer shows up for the third year in a row in the longer-term category, thanks to its brilliant consumer marketing and the irresistible appeal of the iPod and the iTunes music service. Next year may be when the long-rumored Apple cell phone finally makes its debut. Apple followers on Wall Street are forecasting 20% a year profit growth during the next three to five years.

What's more surprising in this screen is that Yahoo! Inc. is beating ple in earnings growth, up 25%. Sha in the Internet portal, which has b beset by competition from Google all year and, more recently, by a sha up in senior management, dropped 3 this year (through Dec. 8). But Yahoo mains a powerful brand on the Web, analysts point to the company's "Pro Panama," which many believe is ke revitalizing its search and advertis businesses, to explain their bullishn Google, for the record, is projectec have a 33% earnings growth rate.

Another good list is "Head of the Pa

HEAD OF THE PACK

Companies whose return on equity and earnings growth beat industry averages

	RETURN ON EQUITY	CHANGE IN EARNINGS 2006-07
UAL UAUA	246.7%	774%
AMAZON.COM AMZN	149.0	63
COLGATE-PALMOLIVE CL	78.6	12
WINDSTREAM WIN	69.7	5
SOUTHERN COPPER PCU	52.8	15
AMERICAN STANDARD ASD	51.0	14
AVON PRODUCTS AVP	48.5	56
KELLOGG K	41.1	10
CATERPILLAR CAT	38.8	8
HARLEY-DAVIDSON HOG	35.9	11

QUALITY YIELDS

The highest-yielding companies with an S&P Equity Ranking of at least A-

	YIELD
WASHINGTON MUTUAL WM	4.85%
AMEREN AEE	4.64
FIRST HORIZON NATIONAL FHN	4.52
BRISTOL-MYERS SQUIBB BMY	4.51
WPS RESOURCES WPS	4.40
NATIONAL CITY NCC	4.32
SOUTHERN SO	4.28
PINNACLE WEST CAPITAL PNW	4.26
BANK OF AMERICA BAC	4.16
WACHOVIA WB	4.13

BIG CAPS TO WATCH

The profits of these large-cap companies are forecast to jump next year

	PRICE CHANGE DEC. 31, 2005- NOV. 30, 2006	CHANGE IN EARNINGS 2006-07
EASTMAN KODAK EK	11%	177%
TRANSOCEAN RIG	12	161
AMR AMR	44	139
PRIDE INTERNATIONAL PDE	5	118
CELGENE CELG	72	102
ELECTRONIC ARTS ERTS	7	97
LAM RESEARCH LRCX	47	91
BOEING BA	26	87
NII HOLDINGS NIHD	49	68
ELECTRONIC DATA SYSTEMS EDS	13	64

MID-CAPS TO WATCH

These companies have lower market value, b earnings don't take second place to larger br

	PRICE CHANGE DEC. 31, 2005- NOV. 30, 2006
AGERE SYSTEMS AGR	39%
UAL UAUA	NA
MASSEY ENERGY MEE	-27
BURGER KING HOLDINGS BKC	NA
AIRTRAN HOLDINGS AAI	-22
WENDY'S INTERNATIONAL WEN	NA
SAKS SKS	22
SHAW GROUP SGR	3
TALBOTS TLB	-10
BORDERS GROUP BGP	6

Boeing and Eastman Kodak, once tarnished, have both been polished up

focuses on those companies whose gs growth rates and return on equi- those of their peers. Last year, the aders returned 16.5%. This year's ludes familiar names Caterpillar, Products, Amazon.com, Harley- on, and Kellogg.

unfamiliar name is Southern Cop- rp., which mines the red metal in Latin America. Shares trade at about eight times next year's expected earnings, and it throws off a dividend of almost 10%. Even if global growth moderates in 2007, copper supplies should remain tight, and there is little new supply coming on line. In fact, recent merger activity suggests more companies are digging for metal on Wall Street than in the ground.

Buying stocks just for their dividends can be tricky. Often, the yield is high because investors won't buy the stock, fearing the payout is unsustainable and management will cut the dividend. That's why we run a "Quality Yield" screen through the data base. We're looking for the highest-yielding companies that also merit an S&P rating of at least A-, the third-highest ranking for financial strength. Many of the names on the list are banks, with dividends above 4%. Not surprising, several are utilities. At 4.64%, the Midwestern utility Ameren has a higher yield than the 10-year Treasury bond.

For those who like bargains, we've chosen some stocks that sell at prices that are low relative to their book value. A second list combines low price-to-book values with low p-e's. Both are so dominated by homebuilders you could put a "For Sale" sign on top of them.

The housing sector's woes have been well-documented, and much bad news has already been reflected in share prices. To buy these, you're making a contrarian play, betting any good news for builders will send shares aloft.

These screens won't catch all the winners. This time last year, for example, the stocks which turned out to have the best returns of the 900—Allegheny Technologies, Charter Communications, and General Cable—were not at the top of our lists. You have lots more ways to slice and dice the Scoreboard data. Sharpen your knives. ■

2007 EARNERS

companies projected perior earnings in 2007

	PRICE CHANGE DEC. 31, 2005- NOV. 30, 2006	CHANGE IN EARNINGS 2006-07
EMS AGR	39%	890%
W	-24	175
G	72	102
ARTS ERTS	7	97
CH LRCX	47	91
	4	71
SLR	-9	69
S NIHD	49	68
ECD	6	68
DATA SYSTEMS EDS	13	64

TECH: LONG-TERM GROWTH

Technology companies expected to deliver better-than-average earnings growth

	PRICE CHANGE DEC. 31, 2005- NOV. 30, 2006	LONG-TERM EARNINGS GROWTH
CELGENE CELG	72%	54.4%
NII HOLDINGS NIHD	49	41.5
GOOGLE GOOG	17	32.5
GENENTECH DNA	-12	29.3
NETWORK APPLIANCE NTAP	45	25.0
YAHOO YHOO	-31	25.0
LEVEL 3 COMMUNICATIONS LVLT	86	22.5
IRON MOUNTAIN IRM	2	22.5
LAM RESEARCH LRCX	47	20.0
APPLE COMPUTER AAPL	28	20.0

APPRECIATED STOCKS

with low price-to-book and gs ratios

	PRICE AS PERCENT OF BOOK VALUE	PRICE-EARNINGS RATIO
LYMPIC USA TOA	54.5%	4.8
CIFIC SPF	88.8	4.6
ITIES WCI	72.5	6.5
Y FINANCIAL NEW	96.7	5.4
ES USA BZH	105.7	5.1
NTERPRISES HOV	114.3	5.5
	91.4	7.7
IDE YRCW	101.8	7.4
A FINANCIAL LFG	79.6	8.6
IGS MDC	118.6	6.3

LOW PRICE-TO-BOOK STOCKS

Companies with low price-to-book ratios and an S&P equity ranking of at least A-

	PRICE AS PERCENT OF BOOK VALUE	S&P EQUITY RANKING
MOLSON COORS BREWING TAP	104.4%	A-
BEAZER HOMES USA BZH	105.7	A-
MGIC INVESTMENT MTG	114.0	A
CINCINNATI FINANCIAL CINF	118.5	A-
M.D.C. HOLDINGS MDC	118.6	A+
OLD REPUBLIC INTL. ORI	120.5	A-
CENTEX CTX	128.6	A+
HORTON (D.R.) DHI	129.2	A+
PULTE HOMES PHM	130.8	A+
FRED'S FRED	131.7	A-

Prices as of Nov. 30. All other data as of Dec. 8

n Fi ll, Standard & Poor's Compustat

Outlook Scoreboard 2006

The data and projections you need to make informed choices

COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
ALL-INDUSTRY COMPOSITE	**15878.8**	**165**	**16**	**23.5**	**17.9**	**419**	**22**	**1.6**	**20.2**	**2.2**	**1.30**	**8.20**	**9.06**	**9.25**	**12.2**
CONSUMER DISCRETIONARY SECTOR COMPOSITE	9080.6	45	14	24.1	15.2	403	24	1.2	15.9	17	1.02	2.30	2.69	2.68	13.1
1 AUTOMOBILES & COMPONENTS															
INDUSTRY GROUP COMPOSITE	**5381.0**	**32**	**8**	**26.8**	**-7.9**	**330**	**15**	**0.5**	**9.1**	**1.7**	**1.30**	**-0.90**	**1.36**	**2.20**	**10.2**
(A) AUTO COMPONENTS															
INDUSTRY COMPOSITE	3121.6	31	6	25.9	-1.6	330	15	0.3	6.0	2.0	1.41	-0.28	1.17	2.20	9.9
American Axle & Mfg. Holdings AXL	949.5	18	0	-17.4	-3.1	100	NM	0.3	5.5	4.8	3.28	1.10	0.39	1.64	10.0
ArvinMeritor ARM (9)	1222.1	17	20	NM	-27.6	129	NM	0.1	NM	NM	2.31	0.90	-2.51 *	1.17	10.0
Autoliv ALV	4759.1	59	29	56.7	15.5	200	13	0.8	7.1	1.5	2.53	3.26	4.08	4.33	9.5
BorgWarner BWA	3326.4	58	-5	34.9	12.5	177	14	0.8	7.3	1.2	1.18	4.17	3.99	4.60	12.0
Cooper Tire & Rubber CTB	811.5	13	-14	NM	-6.8	92	NM	0.3	11.2	NM	3.17	-0.24	-0.44	0.48	NA
Goodyear Tire & Rubber GT	2982.5	17	-3	NM	-6.8	1695	NM	0.1	4.7	NA	0.00	1.21	0.92	1.67	NA
Johnson Controls JCI (9)	15905.3	81	12	14.2 b	14.0	216	15	0.5	9.2	1.1	1.62	3.90	5.25 *	6.03	14.0
Lear LEA	2085.2	31	9	NM	-59.5	186	NM	0.1	NM	NM	0.00	-20.57	-0.55	1.47	9.0
Modine Mfg. MOD (3)	796.6	25	-25	41.0	10.4	152	15	0.5	6.6	NA	2.85	1.78	1.33	1.50	NA
Tenneco TEN	1073.5	24	20	NM	20.5	488	24	0.2	4.8	1.7	0.00	1.29	1.31	1.93	10.5
TRW Automotive Holdings TRW	2510.7	25	-6	NA	13.7	171	13	0.2	3.5	1.4	0.00	1.99	1.95	2.22	9.0
Visteon VC	1037.2	8	28	NM	NM	NM	1	0.1	0.6	NM	0.00	-2.14	-1.63	-0.67	5.5
(B) AUTOMOBILES															
INDUSTRY COMPOSITE	10803.4	33	15	29.1	-21.7	335	18	0.9	15.1	1.3	1.04	-2.38	1.82	2.21	10.6
Fleetwood Enterprises FLE (4)	490.1	8	-38	NM	-7.6	321	NM	0.2	13.8	NM	0.00	-0.10	-0.72	0.25	15.0
Ford Motor F	15356.7	8	5	NM	-74.4	168	NM	0.1	2.2	NM	0.00	1.14	-1.32	-1.09	7.9
General Motors GM	16532.8	29	51	NM	-86.0	148	NM	0.1	29.5	1.2	3.42	-18.50	4.20	4.73	5.9
Harley-Davidson HOG	19116.3	74	43	24.3	35.9	672	19	3.2	15.5	1.6	1.14	3.41	3.91	4.34	12.0
Thor Industries THO (7)	2521.3	45	13	34.0 b	23.6	368	16	0.8	14.3	1.2	0.62	2.13	3.03 *	2.81	12.0
2 CONSUMER DURABLES & APPAREL															
INDUSTRY GROUP COMPOSITE	**4737.2**	**55**	**2**	**28.0**	**17.7**	**264**	**20**	**1.0**	**10.6**	**1.5**	**1.27**	**5.37**	**5.17**	**3.92**	**12.3**
(A) HOUSEHOLD DURABLES															
INDUSTRY COMPOSITE	4130.7	63	-11	31.4	19.3	194	19	0.7	8.6	1.1	1.30	7.64	7.03	4.77	12.0
American Greetings AM (2)	1427.7	24	8	NA	5.4	123	28	0.8	NA	2.9	1.34	1.23	0.81	1.39	10.0
Beazer Homes USA BZH (9)	1798.5	46	-37	25.5 b	22.8	106	5	0.3	3.8	0.4	0.88	5.87	8.89 *	2.74	12.5
Black & Decker BDK	5840.3	86	-1	52.1	41.3	490	13	0.9	9.0	1.2	1.77	6.69	7.02	7.38	10.0
Centex CTX (3)	6556.6	55	-23	36.4	18.7	129	8	0.4	6.5	1.4	0.29	9.20	3.82	3.05	10.0
Fortune Brands FO	12247.0	81	4	2.9 a	16.9	277	16	1.5	12.3	1.4	1.93	3.87	5.27	5.57	11.3
Furniture Brands International FBN	855.3	17	-23	1.1	7.8	95	12	0.4	7.9	1.2	3.72	1.18	1.34	1.48	10.5
Harman International Industries HAR (6)	6770.1	104	6	44.9 b	21.3	559	27	2.0	17.6	1.4	0.05	3.31	3.75 *	4.45	20.0
Horton (D.R.) DHI (9)	8336.2	27	-25	29.4 b	19.1	129	7	0.6	6.5	0.7	2.25	4.62	3.90 *	1.98	10.0
Hovnanian Enterprises HOV (10)	2193.4	36	-28	58.0	20.6	114	5	0.4	4.4	0.6	0.00	7.16	4.97	2.65	12.5
Jarden JAH	2496.2	37	23	NM	6.9	235	33	0.7	18.3	1.1	0.00	0.22	2.28	2.47	15.0
La-Z-Boy LZB (4)	605.1	12	-13	NM	0.6	121	196	0.3	18.8	2.0	4.07	-0.06	0.35	0.71	17.0

FOOTNOTES. *Actual, not estimated data. NA=not available. NM=not meaningful. NR=not ranked. (a) Four-year compound growth rate. (b) Final year of growth rate calculation is 2006 (c) Final year of growth rate calculation is Pro forma data. Data compiled by Compustat from sources such as statistical services, registration statements, and company reports that Compustat believes to be reliable but are not guaranteed by Compustat or BusinessWe correctness or completeness. This material is not an offer to buy or sell any security. Additional data: Thomson First Call

The Glossary

A quick guide to what is included in these tables

MARKET VALUE: Share price on Nov. 30, 2006, multiplied by the latest available common shares outstanding.

RECENT SHARE PRICE: Price for a single share of a company's most widely traded issue of common stock as of the close of trading Nov. 30, 2006.

PRICE CHANGE: Percentage change in the company's most widely traded common-stock issue since Dec. 31, 2005.

EARNINGS GROWTH: Compound annual growth rate, calculated using the 2001 and 2005 restated diluted earnings per share (unless noted otherwise).

RETURN ON EQUITY: The latest available net income available for shareholders divided by total equity.

PRICE AS PERCENTAGE OF BOOK VALUE: Share price on Nov. 30, 2006, as a percentage of the latest available book value per share, which is the sum of common stock at nominal balance-sheet value, capital surplus, and retained earnings as shown in company accounts divided by the number of shares outstanding.

P-E RATIO: Price-earnings ratio based on the latest available 12 months earnings and Nov. 30, 2006, stock price.

PRICE-SALES RATIO: Based on the latest available 12 months sales and the Nov. 30, 2006, stock price.

PRICE-CASH FLOW RATIO: The Nov. 30, 2006 stock price divided by the latest available 12 months cash flow. Cash flow is equal to income from continuing operations before extraordinary items plus depreciation and amortization.

PRICE-EARNINGS TO GROWTH RATE: The price-earnings ratio based on the 2006 earnings estimate and Nov. 30, 2006, stock price, divided by the long-term earnings growth rate.

DIVIDEND YIELD: Indicated annual dividend as a percent of the Nov. 30, 2006, stock price.

EARNINGS PER SHARE: Diluted earnings per share—net income (including proceeds from certain convertible securities, warrants, and options that are common-stock equivalents, but excluding extraordinary profits or losses) divided by number of common and comm equivalent shares.

EARNINGS PER SHARE ESTIMATES Analysts' consensus estimates for and 2007 compiled by Thomson I

LONG-TERM EARNINGS GROWTH: median estimate by analysts of th growth rate of earnings compiled I Thomson First Call. For most com this is for the next 3 to 5 years.

S&P EQUITY RANKING: A measure company's historical growth of ea and dividends, using Standard & F computerized scoring system bas most recent 10 years of earnings p and dividends.

TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE: 2005 ACTUAL	ESTIMATES FROM ANAYLSTS: 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
& Platt LEG	4259.0	24	4	8.4	11.7	181	16	0.8	9.8	1.0	2.86	1.30	1.59	1.80	15.0	B+
EN (11)	8319.0	53	-14	31.5	23.1	140	6	0.5	5.9	0.9	1.22	8.17	5.98	3.12	10.0	A
oldings MDC	2569.8	57	-8	31.8	19.3	119	6	0.5	5.7	0.9	1.75	10.99	5.98	2.60	11.0	A+
Homes MTH	1268.3	49	-23	42.6	32.0	127	4	0.3	3.8	0.5	0.00	8.88	9.05	3.93	10.0	B+
Industries MHK	5241.8	77	-11	10.5	11.7	148	13	0.7	7.8	1.1	0.00	5.30	6.19	6.45	11.0	B+
ubbermaid NWL	7834.8	28	20	12.6	25.4	430	17	1.2	NA	1.6	2.95	1.30	1.86	1.72	9.5	B
R	3358.8	595	-15	37.8	62.1	309	6	0.5	4.9	0.5	0.00	89.61	88.79	53.31	12.5	B+
mes PHM	8590.2	34	-14	37.7	18.7	131	7	0.6	6.6	1.2	0.47	5.47	3.06	1.85	9.5	A+
roup RYL	2243.0	53	-27	40.5	30.5	157	6	0.5	4.7	0.7	0.91	9.03	7.74	4.28	10.0	A-
(11)	1353.8	15	NA	NM	NM	NM	19	0.9	15.0	1.0	2.02	0.76	0.97	1.14	15.0	NR
SNA	2768.2	48	26	44.0	8.7	268	31	1.1	19.9	2.0	2.27	1.59	1.97	2.30	12.0	B
Pacific SPF	1650.7	26	-30	36.6	20.3	89	5	0.4	4.3	0.6	0.62	6.30	3.96	1.66	11.5	NR
Works SWK	4148.1	51	6	19.7	17.8	276	16	1.1	10.8	1.3	2.35	3.18	3.45	3.95	11.5	B+
l Olympic USA TOA	555.4	9	-56	21.7	11.6	55	5	0.2	2.0	0.6	0.64	3.68	1.38	1.11	11.0	NR
ers TOL (10)	4941.8	32	-7	30 b	20.1	145	8	0.8	6.9	0.7	0.00	4.78	4.17 *	1.98	11.0	B+
munities WCI	777.2	19	-31	9.8	11.9	72	6	0.3	5.1	0.7	0.00	4.00	2.09	-0.05	12.5	NR
l WHR	6653.4	85	2	87.6	15.4	214	13	0.4	6.8	0.9	2.02	6.19	6.09	8.56	15.0	B+
URE EQUIPMENT & PRODUCTS																
Y COMPOSITE	4474.7	32	10	24.9	14.0	408	17	1.0	11.1	3.6	2.05	0.96	1.66	1.91	10.7	
k BC	2971.3	32	-20	42.0	15.1	146	10	0.5	6.3	1.3	1.85	3.90	2.44	2.24	10.0	B
Kodak EK	7467.7	26	11	NM	-41.4	412	NM	0.5	10.2	13.5	1.92	-5.05	0.43	1.19	4.5	B-
AS	4232.4	27	33	34.8	15.2	298	23	1.4	11.4	2.1	1.79	1.09	1.30	1.50	10.0	B
AT	8319.1	22	39	9.2	25.5	362	15	1.5	11.0	1.8	2.96	1.01	1.30	1.44	9.5	B
dustries PII	1771.6	45	-10	12.3	36.2	532	16	1.0	9.2	1.4	2.75	3.29	2.71	2.94	12.0	A-
. POOL	2085.8	41	10	26.3	33.5	698	23	1.1	18.5	1.3	1.03	1.50	1.81	2.16	18.0	B+
TILES, APPAREL & LUXURY GOODS																
Y COMPOSITE	6283.6	48	25	21.3	15.9	350	23	1.6	14.8	1.5	0.81	2.28	2.59	2.94	13.7	
oe BWS (1)	1357.4	47	68	NM	13.1	272	21	0.6	12.6	1.4	0.67	1.45	2.42	2.67	14.0	B
H (6)	15850.2	43	30	56.8 b	44.1	1330	32	7.2	26.6	1.7	0.00	0.92	1.27 *	1.65	20.0	NR
parel Group JNY	3702.7	34	9	6.0	7.0	144	21	0.8	13.1	1.7	1.67	2.30	2.20	2.49	9.0	B+
KWD (1)	803.4	31	31	-16.9	4.8	128	41	0.3	NA	2.3	2.05	0.85	1.62	1.82	8.5	B
rne LIZ	4364.4	43	19	12.6	12.7	214	17	0.9	10.9	1.4	0.53	2.94	3.02	3.32	10.0	A
(5)	24806.8	99	14	21.0	21.5	399	19	1.6	15.3	1.3	1.50	5.28	5.63	6.37	14.0	A+
an Heusen PVH (1)	2731.0	49	52	48.5	16.0	302	19	1.4	15.4	1.1	0.30	1.85	2.59	3.05	17.0	B
Lauren RL (3)	8156.3	78	39	13.2	16.8	371	23	2.0	16.0	1.3	0.26	2.87	3.63	4.09	16.5	NR
ZQK (10)	1782.2	15	5	31.2	7.5	219	30	0.8	14.2	1.3	0.00	0.86	0.73	0.91	15.5	B+
d TBL	1957.9	31	-4	16.3	21.4	364	18	1.3	13.8	1.5	0.00	2.43	1.65	1.70	12.5	B+
	8717.6	78	42	24.5	17.7	279	16	1.3	13.0	1.5	2.81	4.54	5.06	5.55	10.0	A-
roup WRNC	1173.2	26	-3	NM	7.8	178	24	0.7	11.9	1.1	0.00	1.06	1.30	1.69	17.5	NR
UMER SERVICES																
GROUP COMPOSITE	11133.5	40	20	24.9	21.1	471	27	2.2	14.8	2.0	1.04	1.68	1.79	2.00	13.6	
ELS RESTAURANTS & LEISURE																
COMPOSITE	12944.3	44	28	24.8	21.0	488	28	2.4	15.2	2.1	0.98	1.76	1.88	2.15	14.1	
Farms BOBE (4)	1237.6	34	47	-5.6	8.5	172	20	0.8	9.3	NA	1.65	1.52	1.50	1.80	NA	A-
ing BYD	3659.8	42	-11	45.2	12.3	350	30	1.6	11.8	1.6	1.28	1.78	2.09	2.07	13.0	B
ternational EAT (6)	3762.3	30	18	13.2 b	20.3	343	12	0.9	9.1	1.3	1.19	1.14	1.63 *	1.76	14.4	B+
g Holdings BKC (6)	2438.3	18	NA	NA	7.5	407	53	1.2	NA	5.4	0.00	0.44	0.24 *	1.04	14.3	NR
CL (11)	38898.1	49	-8	14.5	12.4	218	18	3.4	12.3	1.2	2.25	2.70	2.73	3.06	15.0	A+
p CBRL (7)	1326.5	43	22	12.0 b	32.9	413	17	0.5	7.6	1.7	1.31	2.45	2.50 *	2.70	10.0	B+
urants CKR (1)	1187.6	18	36	NM	52.7	312	7	0.8	4.6	1.2	0.87	2.70	0.75	0.99	20.0	B-
staurants DRI (5)	5895.1	40	3	14.2	27.0	466	18	1.0	10.4	1.4	1.15	2.16	2.38	2.65	12.4	A
Pizza DPZ	1711.3	27	13	NA	NM	NM	16	1.2	11.6	1.5	1.75	1.58	1.63	1.76	11.5	NR
ntertainment HET	14632.3	79	10	3.9	6.8	241	36	1.6	13.0	1.7	2.03	1.75	3.58	4.16	12.9	B
els HLT	12692.5	33	36	25.9	14.0	378	29	1.8	14.7	1.9	0.49	1.13	1.15	1.29	15.0	B
al Game Technology IGT (9)	14863.3	44	42	16.0 b	23.2	728	33	5.9	21.0	2.5	1.19	1.20	1.34 *	1.55	13.3	B+
Box JBX (9)	2177.4	61	76	11.0 b	15.3	306	20	0.8	11.8	2.0	0.00	2.48	3.04 *	3.05	10.1	B+
Sands LVS	32447.1	92	132	151.5	22.5	1663	74	15.4	60.0	3.0	0.00	0.80	1.34	1.80	22.5	NR
ternational MAR	17851.9	45	35	28.8	27.2	661	27	1.5	19.4	1.9	0.55	1.45	1.62	1.87	15.0	B+
s MCD	51904.3	42	24	13.0	18.8	334	18	2.4	12.5	2.1	2.38	2.04	2.41	2.56	8.5	A
ge MGM	15086.8	54	47	31.6	15.4	426	29	2.0	12.7	1.8	0.00	1.50	2.03	2.42	15.1	B
bean Cruises RCL	8922.9	42	-6	23.3	9.7	148	16	1.7	8.9	1.2	1.41	3.03	2.93	3.12	12.0	A-
SBUX (9)	27119.9	35	18	28.8 b	23.2	1083	48	3.5	28.0	2.2	0.00	0.61	0.73 *	0.89	22.0	B+
otels & Resorts Worldwide HOT	13591.1	64	0	27.6	38.9	494	13	2.3	10.0	1.7	NA	1.88	2.55	2.47	15.0	NR
ternational WEN	3839.3	33	NA	3.9	2.8	208	76	1.4	19.5	5.6	1.04	1.92	0.48	1.22	12.0	A-
Worldwide WYN	6257.6	32	NA	NA	9.7	173	18	1.7	12.7	NA	0.00	NA	1.79	1.94	NA	NR
ds YUM	16215.4	61	31	12.0	61.6	1221	21	1.7	12.6	1.8	0.98	2.55	2.90	3.22	12.0	B+
RSIFIED CONSUMER SERVICES																
COMPOSITE	4192.2	25	-6	25.6	21.2	407	24	1.5	13.2	1.8	1.27	1.40	1.44	1.45	12.0	
up APOL (8)	6711.8	39	-36	30.1 b	64.0	980	16	2.7	NA	1.0	0.00	2.39	2.49 *	2.38	15.0	B+
(H) HRB (4)	7726.2	24	-2	5.9	19.1	474	26	1.6	15.2	1.6	2.25	1.47	1.29	1.66	12.0	A-
cation CECO	2391.1	25	-25	56.2	10.0	253	26	1.2	13.1	1.2	0.00	2.32	1.55	1.39	13.2	B

Working the Numbers | Scoreboard

COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
Regis RGS (6)	1718.5	38	-1	10.2 b	12.6	196	16	0.7	7.5	1.4	0.42	1.39	2.36 *	2.18	11.6
Service Corp. International SCI	2889.2	10	21	NM	5.0	180	37	1.7	16.9	3.4	1.22	0.19	0.32	0.40	9.2
ServiceMaster SVM	3716.7	13	8	NM	16.5	357	22	1.1	NA	1.9	3.71	0.61	0.61	0.68	11.0
4 MEDIA															
INDUSTRY GROUP COMPOSITE	**18178.5**	**58**	**24**	**13.0**	**13.0**	**549**	**29**	**1.9**	**18.7**	**2.0**	**1.07**	**1.65**	**2.37**	**2.65**	**13.8**
ADVO AD (9)	942.7	30	5	-16.8 b	10.2	462	45	0.7	14.8	4.5	0.00	1.27	0.66 *	1.32	10.0
Belo BLC	1857.4	18	-15	NM	8.1	126	16	1.2	8.6	2.4	2.75	1.12	1.14	1.08	6.7
Cablevision Systems CVC	8110.5	28	18	NM	NM	NM	NM	1.4	7.9	NM	0.00	-0.45	-0.49	0.14	11.0
CBS CBS	22806.3	30	NA	NM	-35.2	98	NM	1.6	NM	1.6	2.69	-10.54	1.67	1.82	10.9
Charter Communications CHTR	1258.9	3	142	NA	NM	NM	NM	0.2	NM	NM	0.00	-3.13	-3.43	-2.80	9.0
Clear Channel Communications CCU	17361.9	35	12	NM	8.5	222	27	2.5	13.4	2.3	2.13	1.16	1.34	1.53	11.3
Clear Channel Outdoor Holdings CCO	9128.0	26	28	NM	8.9	632	70	3.3	17.0	3.0	0.00	0.19	0.40	0.53	21.3
Comcast CMCSA	84203.2	40	56	NM	4.8	207	44	3.6	14.9	2.6	0.00	0.42	0.89	1.35	17.2
DIRECTV Group DTV	27725.2	23	61	NM	19.1	446	25	2.0	13.1	1.2	0.00	0.22	1.08	1.32	17.0
Disney (Walt) DIS (9)	68215.2	33	38	28.6 b	10.6	214	20	2.0	14.2	1.4	0.94	1.24	1.64 *	1.73	14.4
Dow Jones DJ	3010.7	36	2	-10.5	47.7	1043	22	1.7	12.6	2.4	2.77	0.73	1.06	1.48	14.5
EchoStar Communications DISH	16023.5	36	32	NM	NM	NM	28	1.7	9.8	1.2	0.00	3.22	1.36	1.94	21.3
Gannett GCI	13958.9	60	-2	5.2 a	13.8	167	12	1.8	9.8	1.4	2.08	4.92	4.89	4.84	9.0
Interpublic Group IPG	5281.0	12	24	NM	-9.6	505	NM	0.9	126.3	NM	0.00	-0.70	-0.06	0.31	10.1
Liberty Capital LCAPA	12350.1	88	NA	NA	NA	61	NA	NA	NA	NA	0.00	NA	1.87	-0.17	NA
Liberty Global LBTYA	10813.8	27	20	NA	-2.2	153	NM	1.8	6.6	NM	0.00	-0.20	-0.45	-0.24	15.0
Live Nation LYV	1403.8	21	64	NA	-18.7	209	NM	0.4	NM	NM	0.00	-1.96	-0.10	0.72	NA
McGraw-Hill MHP	23607.4	67	29	23.2	33.3	906	28	3.8	23.0	2.2	1.09	2.21	††	††	††
†† Since *BusinessWeek* is owned by the McGraw-Hill Companies, the Scoreboard does not include forecasts of the company's earnings															
Meredith MDP (6)	2587.1	54	3	14.4 b	21.2	368	18	1.6	13.3	1.6	1.18	2.50	2.86 *	3.28	12.0
New York Times NYT	3478.9	24	-9	9.6	11.0	225	21	1.1	NA	2.2	2.90	1.82	1.39	1.24	7.8
News Corp. NWS.A (6)	65100.3	21	32	NA	10.0	212	21	2.5	16.8	1.4	0.58	NA	0.87 *	1.02	16.9
Omnicom Group OMC	17459.1	102	20	15.1	22.8	474	21	1.6	17.7	1.7	0.98	4.36	5.00	5.59	12.0
Regal Entertainment Group RGC	3125.3	21	9	20.5	NM	NM	35	1.2	10.7	2.9	5.77	0.59	0.73	0.95	10.0
Scholastic SCHL (5)	1407.6	33	17	-9.6	4.3	141	32	0.7	12.8	1.6	0.00	1.63	1.69	2.42	12.0
Scripps (E.W.) SSP	7978.4	49	2	NA	10.7	323	31	3.2	21.1	1.9	0.98	1.35	2.29	2.51	11.5
Time Warner TWX	80602.3	20	15	NM	7.7	130	19	1.8	NA	1.8	1.09	0.62	0.84	1.01	13.0
Tribune TRB	7592.9	32	5	56.3	12.5	171	17	1.4	9.5	2.1	2.26	1.67	1.94	2.06	7.7
Univision Communications UVN	10948.4	36	21	25.2	5.1	202	43	5.1	29.7	2.0	0.00	0.54	1.05	1.23	17.3
Viacom VIA.B	24340.2	38	NA	NA	17.3	346	22	2.3	15.7	1.1	0.00	1.73	1.98	2.27	16.8
Warner Music Group WMG (9)	3791.5	25	32	NA	103.4	6537	64	1.1	15.0	1.5	2.05	-1.40	0.40 *	0.46	41.7
Washington Post WPO	7063.9	735	-4	7.9	11.9	251	21	1.9	12.8	2.0	1.06	32.59	36.49	38.40	10.0
5 RETAILING															
INDUSTRY GROUP COMPOSITE	**7969.6**	**37**	**17**	**23.3**	**17.3**	**424**	**24**	**0.8**	**20.6**	**1.7**	**0.76**	**1.59**	**1.91**	**2.27**	**13.9**
(A) DISTRIBUTORS															
INDUSTRY COMPOSITE	2374.4	28	-10	18.9	13.4	168	17	0.3	11.6	1.0	1.13	2.14	2.21	2.24	13.7
Building Materials Holding BLG	715.4	25	-28	53.2	23.0	126	6	0.2	4.1	0.5	1.62	4.41	3.80	3.26	13.5
Core-Mark Holding CORE	329.0	32	2	-6.5	10.4	160	16	0.1	10.1	NA	0.00	1.37	1.60	1.78	NA
Genuine Parts GPC	7990.2	47	7	10.0	16.7	287	17	0.8	14.9	1.7	2.88	2.50	2.76	3.02	10.0
Source Interlink SORC (1)	463.0	9	-20	NM	3.4	99	30	0.3	17.3	0.8	0.00	0.28	0.67	0.90	17.5
(B) INTERNET & CATALOG RETAIL															
INDUSTRY COMPOSITE	11086.8	32	-3	115.7	52.0	2895	43	2.0	22.6	2.4	0.00	1.04	1.00	1.22	16.3
Amazon.com AMZN	16579.7	40	-14	NM	149.0	8459	58	1.7	35.2	4.1	0.00	0.78	0.43	0.70	22.9
Expedia EXPE	6009.0	18	-24	115.7	3.5	104	32	2.7	16.2	1.4	0.00	0.65	1.06	1.17	12.4
IAC/InterActiveCorp IACI	10671.7	36	29	NM	3.4	122	40	1.6	16.4	1.8	0.00	1.68	1.52	1.79	13.4
(C) MULTILINE RETAIL															
INDUSTRY COMPOSITE	12415.5	46	28	21.6	14.1	325	21	0.7	11.4	2.7	0.55	1.57	2.22	2.76	12.0
Big Lots BIG (1)	2402.4	22	86	NM	5.7	235	43	0.5	15.0	3.3	0.00	0.14	0.89	1.02	7.5
Dillard's DDS (1)	2829.6	36	43	15.1	7.8	116	15	0.4	5.8	2.8	0.45	1.49	2.16	2.23	6.0
Dollar General DG (1)	4847.8	16	-19	15.4	17.6	282	16	0.5	9.8	1.8	1.29	1.08	0.88	1.00	10.0
Dollar Tree Stores DLTR (1)	3061.0	30	25	10.1	15.6	264	18	0.8	9.2	1.4	0.00	1.60	1.81	2.00	12.1
Family Dollar Stores FDO (8)	4229.1	28	13	1.6 b	16.6	348	21	0.7	12.6	1.8	1.51	1.30	1.30 *	1.65	12.0
Federated Department Stores FD (1)	22877.8	42	27	25.6	6.9	175	26	0.8	10.5	1.9	1.21	3.16	2.15	3.00	10.5
Fred's FRED (1)	471.2	12	-28	5.6	7.6	132	17	0.3	8.4	1.1	0.68	0.66	0.69	0.77	15.0
Kohl's KSS (1)	22786.8	70	43	15.8	18.1	412	24	1.5	17.0	1.2	0.00	2.43	3.25	3.83	18.0
Nordstrom JWN (1)	12593.4	49	31	44.0	32.4	642	21	1.5	13.8	1.4	0.86	1.98	2.51	2.84	14.4
Penney (J.C.) JCP(1)	17378.3	77	39	60.3	28.2	434	16	0.9	11.6	1.0	0.93	3.83	4.86	5.43	16.0
Retail Ventures RVI (1)	893.7	19	53	NM	NM	759	NM	0.3	NM	NM	0.00	-4.75	-1.20	0.43	NA
Saks SKS (1)	2811.0	21	22	NM	-2.0	179	NM	0.7	NA	15.1	0.00	0.16	0.17	0.42	8.0
Sears Holdings SHLD (1)	26741.5	172	48	NM	11.3	230	21	0.5	10.9	1.8	0.00	6.17	8.45	10.37	11.0
Target TGT (1)	49893.5	58	6	22.3	17.6	337	19	0.9	12.2	1.2	0.83	2.71	3.18	3.59	15.0
(D) SPECIALTY RETAIL															

TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
Y COMPOSITE	**6985.4**	**35**	**18**	**21.9**	**16.3**	**325**	**24**	**0.8**	**23.8**	**1.4**	**0.83**	**1.58**	**1.86**	**2.21**	**14.3**	
nbie & Fitch ANF (1)	5937.3	67	3	22.6	32.1	490	16	1.9	12.1	1.0	1.04	3.66	4.63	5.31	15.0	B+
Auto Parts AAP	3745.4	36	-18	101.2	23.8	378	16	0.8	10.2	1.0	0.67	2.13	2.18	2.53	16.5	NR
Eagle Outfitters AEOS (1)	6785.9	45	97	28.6	25.8	509	20	2.6	16.0	1.3	1.00	1.89	2.53	2.82	14.0	B
r Stores ANN (1)	2487.1	35	0	28.8	13.3	222	17	1.1	10.0	1.1	0.00	1.13	2.12	2.44	15.0	B
utomotive Group ABG	785.9	24	43	18.6 a	10.9	130	12	0.1	9.1	1.2	3.40	1.82	1.90	2.04	10.0	NR
on AN	4281.4	21	-5	21.0	9.2	117	15	0.2	10.2	1.2	0.00	1.48	1.53	1.71	11.2	B
AZO (8)	8075.6	114	24	17.0 b	121.2	1720	15	1.4	11.4	1.2	0.00	7.18	7.50 *	8.44	13.0	B+
Noble BKS (1)	2601.6	40	-6	25.4	14.2	251	19	0.5	8.3	1.4	1.50	2.03	2.25	2.43	13.0	B
& Beyond BBBY (2)	10962.2	39	7	26.9	22.7	430	20	1.8	15.7	1.2	0.00	1.92	2.17	2.47	15.0	A-
BBY (2)	26399.3	55	26	17.8	22.9	486	22	0.8	15.3	1.3	0.73	2.27	2.81	3.22	15.5	B+
ter BBI	984.7	5	40	NM	8.2	178	18	0.2	NA	NM	0.00	-3.20	-0.05	0.23	NA	NR
roup BGP (1)	1424.3	23	6	9.7	5.6	193	42	0.4	8.5	3.5	1.75	1.42	0.58	1.10	11.5	B
CAB	1581.6	24	46	11.6	11.0	233	21	0.8	13.6	1.3	0.00	1.10	1.27	1.47	15.0	NR
MX (2)	4918.9	46	67	12.4	15.7	435	28	0.7	23.5	1.6	0.00	1.39	1.64	1.91	18.0	B
Shoppes CHRS (1)	1666.7	14	3	NM	11.3	182	17	0.6	8.5	0.7	0.00	0.76	0.84	0.96	23.5	B-
Place Retail Stores PLCE (1)	1850.4	64	30	7.7	17.1	423	25	1.0	13.9	1.1	0.00	2.21	3.13	3.72	19.5	B
y Stores CC (2)	4342.3	25	10	26.3	9.2	227	26	0.4	NA	1.5	0.64	0.84	1.10	1.41	15.0	B-
rting Goods DKS (1)	2763.0	54	61	20.0	19.5	546	29	0.9	18.2	1.4	0.00	1.35	1.98	2.39	20.0	NR
er FL (1)	3610.9	23	-3	21.4	10.9	169	15	0.6	8.9	1.2	2.18	1.67	1.59	1.76	12.3	B
GME (1)	4249.2	56	76	72.9	9.2	344	38	0.9	19.4	1.5	0.00	1.61	2.03	2.68	18.5	NR
(1)	15387.8	19	6	NM	17.3	296	18	1.0	10.2	1.5	1.71	1.24	1.03	1.18	12.0	A
utomotive GPI	1227.8	51	62	2.9	13.3	181	14	0.2	11.4	1.0	1.10	2.90	3.75	4.32	14.0	B+
nter GTRC	1287.2	44	-12	37.4	13.0	226	17	0.7	11.8	0.9	0.00	2.67	2.59	3.02	18.0	B+
ot HD (1)	78446.0	38	-6	20.5	22.1	283	13	0.9	10.0	1.1	2.37	2.72	2.84	2.93	12.5	A+
ores JAS (1)	465.1	20	67	NM	-12.3	122	NM	0.3	516.7	NM	0.00	-1.01	-0.20	0.30	15.0	B-
rands LTD (1)	12530.2	32	42	8.7	29.7	494	17	1.2	12.2	1.5	1.89	1.62	1.72	1.94	12.0	B+
ors LAD	507.3	26	-18	12.2	8.8	103	13	0.2	8.2	1.2	2.17	2.46	1.99	2.12	10.5	B+
W (1)	47290.9	30	-10	29.8	21.1	313	15	1.0	11.1	1.0	0.66	1.73	1.95	2.04	15.0	A+
rhouse MW(1)	2033.3	38	30	28.5	17.8	281	16	1.1	10.6	NA	0.52	1.88	2.51	2.78	NA	B+
ot ODP	10540.6	38	21	7.2	19.5	422	23	0.7	14.0	1.3	0.00	0.87	1.93	2.38	15.0	B
OMX	3498.4	47	86	NM	1.0	193	196	0.4	22.6	2.0	1.27	-0.58	2.01	2.57	12.0	B-
utomotive ORLY	3599.0	32	-1	23.2	13.5	273	20	1.6	15.0	1.1	0.00	1.45	1.55	1.80	18.0	B+
oeSource PSS (1)	2049.7	31	24	-1.5	14.2	293	21	0.8	NA	1.6	0.00	1.09	1.51	1.70	13.0	B-
Manny, Moe & Jack PBY (1)	733.7	14	-9	NM	-5.2	127	NM	0.3	NA	NM	2.00	-0.65	-0.23	0.07	10.0	B-
PETM (1)	4146.5	30	15	45.4	18.9	437	23	1.0	NA	1.3	0.41	1.25	1.33	1.57	17.5	B
rts PIR (2)	582.2	7	-24	NA	-22.6	121	NM	0.3	NM	NM	0.00	-0.32	-1.03	-0.51	15.0	B
k RSH	2380.6	18	-17	20.8	7.2	396	55	0.5	13.8	2.4	1.43	1.81	0.73	0.93	10.0	B+
enter RCII	1912.8	27	45	26.7	14.8	202	14	0.8	3.0	1.3	0.00	1.83	2.12	2.32	10.0	B
s ROST (1)	4367.2	31	7	9.4	25.6	509	20	0.8	13.3	1.2	0.78	1.36	1.66	1.90	15.0	A+
Williams SHW	8433.2	63	38	18.2	26.8	409	16	1.1	12.5	1.3	1.60	3.28	4.13	4.40	11.5	A
motive SAH	1208.2	29	28	5.0	10.8	137	13	0.2	10.0	1.2	1.68	2.33	2.17	2.66	11.0	B+
LS (1)	18437.1	25	12	21.1 a	19.5	388	20	1.1	14.7	1.3	0.86	1.12	1.28	1.48	15.0	B+
SMRT (1)	683.7	16	-13	31.9	13.9	256	18	0.5	11.2	1.0	1.59	1.15	0.90	1.20	17.5	B
B (1)	1343.6	25	-10	-3.5	7.8	205	26	0.6	8.4	1.8	2.09	1.72	0.92	1.94	15.0	B+
(1)	5308.7	38	0	11.1	15.0	315	22	2.1	14.5	1.8	1.04	1.75	1.77	2.03	12.0	A
)	12325.3	27	18	11.6	37.8	567	16	0.7	10.6	1.4	1.02	1.41	1.63	1.87	12.0	A+
pply TSCO	1915.1	48	-10	31.5	16.4	339	21	0.8	14.4	1.2	0.00	2.09	2.28	2.72	18.0	B+
o Group UAG	2092.4	23	23	30.7	10.3	166	17	0.2	12.0	1.3	1.19	1.29	1.39	1.56	13.0	B+
onoma WSM (1)	3598.7	32	-26	29.2	18.4	317	18	1.0	10.6	1.1	1.26	1.81	1.74	2.00	16.0	B+
7)	1482.3	31	22	-7.2 b	6.5	190	30	0.6	13.1	3.5	0.00	2.05	1.09 *	2.04	8.0	B
ER STAPLES																
OMPOSITE	21409.0	40	14	14.7	38.7	665	21	1.2	14.4	2.0	1.48	2.01	1.80	2.27	10.3	
AND STAPLES RETAILING																
GROUP COMPOSITE	**19874.9**	**33**	**15**	**19.9**	**17.8**	**296**	**20**	**0.4**	**11.9**	**1.6**	**0.80**	**1.53**	**1.64**	**1.82**	**13.0**	
Wholesale Club BJ (1)	2111.9	32	9	13.4	11.2	211	19	0.3	9.8	1.9	0.00	1.87	1.71	1.89	10.0	B+
neral Stores CASY (4)	1254.7	25	0	NA	9.5	226	24	0.3	11.2	1.9	0.80	1.24	1.21	1.52	10.9	A-
olesale COST (8)	24177.2	52	6	11.7 b	12.1	264	23	0.4	14.9	1.7	0.99	2.18	2.30 *	2.59	13.0	A-
V	23685.7	29	9	30.5	14.2	254	18	0.6	11.6	1.2	0.54	1.45	1.54	1.89	15.0	B+
K (1)	15172.2	21	14	1.0	22.0	329	15	0.2	6.7	1.6	1.21	1.31	1.45	1.56	9.1	B
Stores LDG (1)	1534.8	41	13	11.5	10.5	195	19	0.3	9.1	1.0	1.36	1.93	1.97	2.20	21.9	B+
Y (9)	1112.1	49	4	163.6 b	26.5	330	13	0.2	6.7	0.9	0.00	2.64	3.86 *	3.09	14.1	NR
e Food Group PFGC	943.4	27	-5	10.0	5.5	121	22	0.2	14.0	1.6	0.00	0.95	1.21	1.41	14.0	B+
D (2)	2527.9	5	36	NM	75.4	223	3	0.1	1.7	NM	0.00	1.89	0.00	0.06	2.0	B-
VY	13648.8	31	30	-15.4	13.2	245	19	0.3	8.0	1.6	0.75	1.25	1.72	1.92	11.0	B
al SMF	574.1	18	40	-3.9	8.5	194	23	0.3	13.1	NA	0.00	0.69	0.66	0.92	NA	B-
res SPTN (3)	451.6	21	102	12.9	14.3	286	20	0.2	10.5	1.7	0.95	0.96	1.22	1.31	10.0	NR

Working the Numbers | Scoreboard

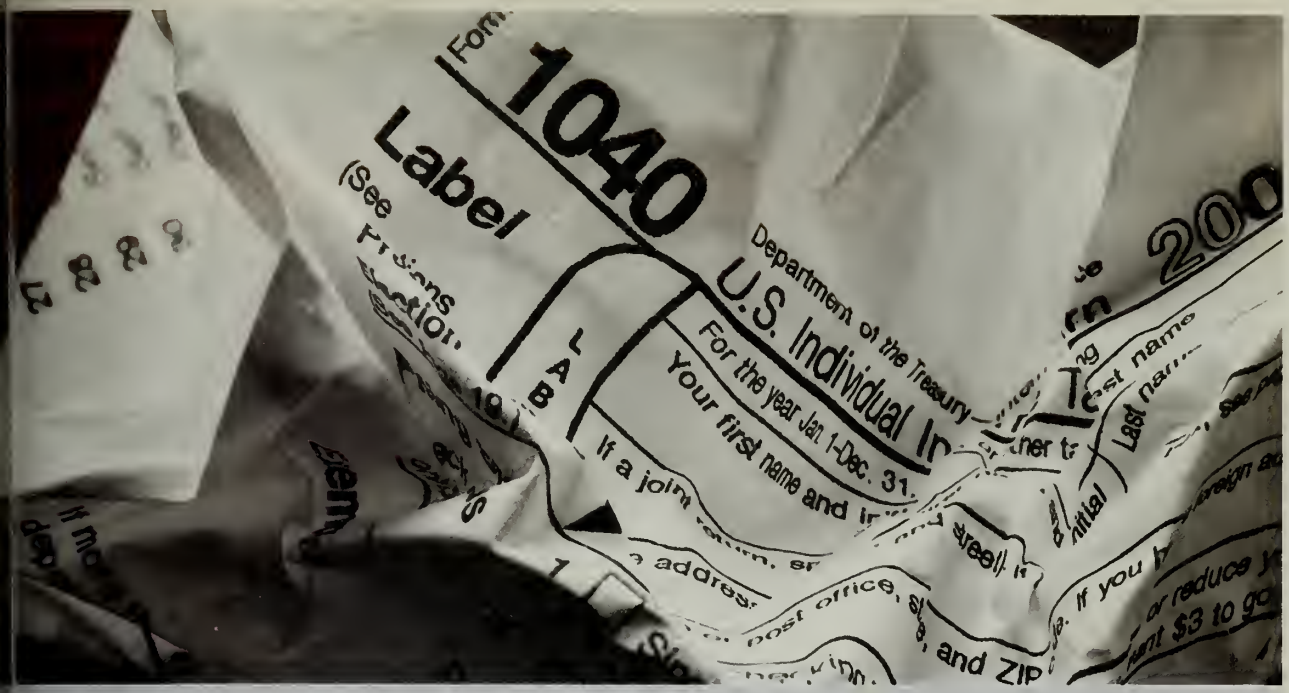
COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE: 2005 ACTUAL	ESTIMATES FROM ANAYLSTS: 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
Supervalu SVU (2)	7091.8	34	5	-0.2	5.8	137	19	0.3	8.9	1.5	1.93	1.46	2.30	2.83	10.0
Sysco SYY (6)	22192.3	36	15	7.5 b	27.8	705	25	0.7	18.1	2.0	2.12	1.47	1.35 *	1.59	13.0
United Natural Foods UNFI (7)	1502.5	35	34	22.7 b	12.7	397	31	0.6	22.8	1.9	0.00	1.00	1.02 *	1.30	18.8
Walgreen WAG (8)	40808.3	40	-9	15.1 b	17.3	403	24	0.9	17.6	1.5	0.77	1.52	1.72 *	1.99	15.2
Wal;Mart Stores WMT (1)	192145.9	46	-1	16.8	20.1	327	16	0.6	11.3	1.2	1.45	2.68	2.87	3.21	13.0
Whole Foods Market WFMI (9)	6812.8	49	-37	20.9 b	14.5	485	35	1.2	18.9	1.8	1.48	0.99	1.41 *	1.51	19.5
7 FOOD BEVERAGE & TOBACCO															
INDUSTRY GROUP COMPOSITE	**19740.1**	**41**	**12**	**12.2**	**50.4**	**807**	**21**	**1.5**	**15.2**	**2.2**	**1.85**	**2.17**	**1.99**	**2.38**	**8.7**
(A) BEVERAGES															
INDUSTRY COMPOSITE	32099.5	44	6	12.6	20.4	391	19	2.0	12.0	1.9	1.73	2.06	2.36	2.66	9.7
Anheuser-Busch BUD	36526.6	48	11	5.6	45.5	841	19	2.3	12.3	2.1	2.48	2.35	2.55	2.80	9.0
Brown-Forman BF.B (4)	8508.0	69	0	20.5	23.7	486	21	4.1	18.8	2.0	1.74	3.20	3.21	3.61	10.9
Coca-Cola KO	109675.9	47	16	6.3	29.3	609	21	4.6	17.7	2.5	2.65	2.04	2.34	2.53	8.0
Coca-Cola Enterprises CCE	9772.0	20	7	NM	8.0	152	19	0.5	6.4	2.0	1.17	1.08	1.27	1.33	8.3
Constellation Brands STZ (2)	6241.7	28	7	14.9	9.8	197	21	1.3	14.4	1.2	0.00	1.36	1.75	2.01	13.0
Molson Coors Brewing TAP	6132.5	71	6	-3.4	5.0	104	21	1.1	8.2	1.7	1.80	2.88	3.94	4.81	10.6
Pepsi Bottling Group PBG	7391.5	31	9	15.9	20.1	320	16	0.6	6.7	1.7	1.40	1.86	1.88	2.07	9.7
PepsiAmericas PAS	2644.6	21	-10	25.1	10.9	170	16	0.7	7.3	2.3	2.40	1.42	1.30	1.43	7.0
PepsiCo PEP	102002.6	62	5	15.8	31.0	634	21	2.9	16.1	1.9	1.94	2.39	3.00	3.30	11.0
(B) FOOD PRODUCTS															
INDUSTRY COMPOSITE	10000.3	35	11	12.8	15.3	378	22	1.1	16.8	2.3	1.56	1.94	1.51	1.95	8.6
Archer Daniels Midland ADM (6)	23069.3	35	42	26.5 b	14.9	224	15	0.6	10.5	1.8	1.14	1.59	2.00 *	2.54	9.5
Bunge BG	8441.2	71	25	26.7	8.6	179	21	0.3	11.7	1.9	0.88	4.43	3.79	4.29	10.0
Campbell Soup CPB (7)	15304.1	38	28	11.9 b	58.2	1207	21	2.0	NA	3.0	2.10	1.56	1.82 *	1.89	7.0
Chiquita Brands International CQB	602.2	14	-29	NA	-7.9	65	NM	0.1	67.9	NM	0.00	2.92	-0.83	0.93	8.0
ConAgra Foods CAG (5)	13086.8	26	27	4.9	9.3	278	35	1.1	NA	2.6	2.80	1.15	1.24	1.34	8.0
Corn Products International CPO	2650.2	36	52	10.4	8.6	206	24	1.1	11.8	2.6	0.99	1.19	1.62	2.04	8.5
Dean Foods DF	5756.8	43	14	13.0	13.8	288	22	0.6	NA	2.2	0.00	1.78	2.12	2.38	9.4
Del Monte Foods DLM (4)	2264.3	11	8	-5.5	8.8	169	19	0.7	11.1	2.0	1.42	0.67	0.75	0.81	7.6
Flowers Foods FLO	1619.3	27	-3	66.1	12.7	290	23	0.9	12.1	1.9	1.88	0.99	1.19	1.38	11.5
Fresh Del Monte Produce FDP	866.6	15	-34	1.0	-8.7	85	NM	0.3	NM	NM	3.33	1.84	-0.17	0.49	9.0
General Mills GIS (5)	19302.8	56	13	21.1	20.7	362	19	1.6	12.6	2.3	2.50	2.90	3.11	3.36	8.0
Gold Kist GKIS (9)	1011.0	20	33	NA	-3.8	214	NM	0.5	NA	NM	0.00	2.22	-0.35 *	0.76	5.0
Heinz (H.J.) HNZ (4)	14645.6	44	32	-6.4	23.5	656	28	1.7	NA	2.7	3.15	1.29	2.35	2.52	7.0
Hershey HSY	12306.1	53	-4	28.9 a	69.4	1482	22	2.5	15.8	2.1	2.04	1.99	2.47	2.69	10.0
Hormel Foods HRL (10)	5226.3	38	16	11.0 b	15.9	290	18	0.9	13.2	1.8	1.58	1.82	2.05 *	2.19	10.0
Kellogg K	19822.4	50	15	19.4	41.1	804	20	1.9	14.5	2.2	2.34	2.36	2.51	2.75	9.0
Kraft Foods KFT	57627.7	35	24	11.3	10.6	190	18	1.7	14.1	2.6	2.85	1.72	1.92	2.02	7.0
McCormick MKC (11)	5088.2	39	25	12.3	22.6	555	25	1.9	17.6	2.4	2.07	1.56	1.70	1.86	9.4
Pilgrim's Pride PPC (9)	1698.5	26	-23	NM	-3.1	152	NM	0.3	16.8	NM	0.35	3.98	-0.51 *	0.89	NA
Ralcorp RAH (9)	1350.1	51	27	8.0 b	14.3	283	21	0.7	10.2	2.3	0.00	2.34	2.41 *	3.01	9.0
Sara Lee SLE (6)	12382.4	17	-12	-16.7 b	20.7	455	22	0.8	11.3	3.9	2.41	1.36	0.53 *	0.81	8.0
Smithfield Foods SFD (4)	2933.0	26	-14	-2.1	8.0	143	18	0.3	NA	1.6	0.00	1.61	1.74	2.14	9.5
Smucker (J.M.) SJM (4)	2752.8	48	9	18.3	8.1	157	20	1.3	13.4	2.2	2.33	2.45	2.75	2.94	8.0
Tyson Foods TSN (9)	5641.0	16	-7	NM	-4.3	127	NM	0.2	17.3	NM	1.01	1.04	-0.56 *	0.63	8.5
Wrigley (Wm.) Jr. WWY	14557.7	52	-1	9.2	20.3	596	30	3.2	21.3	2.5	1.95	1.83	1.99	2.19	10.5
(C) TOBACCO															
INDUSTRY COMPOSITE	52805.8	67	32	6.3	337.2	4424	16	2.9	14.5	2.3	3.94	3.82	4.20	4.41	7.1
Altria Group MO	176465.5	84	13	7.4	27.6	428	16	2.5	13.4	2.1	4.09	5.10	5.31	5.61	7.5
Carolina Group CG	6755.3	62	42	1.1 a	722.0	6675	15	1.8	NA	1.9	2.92	3.62	4.21	4.48	8.0
Reynolds American RAI	18989.0	64	35	10.5	17.1	271	16	2.2	13.9	2.6	4.67	3.34	4.18	4.33	6.0
UST UST	9013.6	56	37	NM	582.3	10322	18	5.0	16.2	2.6	4.07	3.23	3.09	3.22	7.0
8 HOUSEHOLD & PERSONAL PRODUCTS															
INDUSTRY GROUP COMPOSITE	**30512.0**	**49**	**22**	**14.8**	**31.1**	**800**	**24**	**1.7**	**16.8**	**2.1**	**1.29**	**2.25**	**1.40**	**2.70**	**11.2**
(A) HOUSEHOLD PRODUCTS															
INDUSTRY COMPOSITE	39934.3	54	8	15.7	33.0	814	22	1.8	16.1	2.1	1.36	2.53	1.40	3.04	10.6
Church & Dwight CHD	2729.1	42	27	24.2	15.7	327	21	1.5	15.4	1.7	0.67	1.83	2.02	2.32	12.5
Clorox CLX (6)	9716.3	64	12	22.3 b	NM	NM	22	2.1	15.5	2.2	1.94	2.88	2.89 *	3.23	10.0
Colgate-Palmolive CL	33456.5	65	19	6.5	78.6	2017	27	2.8	20.4	2.2	1.97	2.43	2.90	3.26	10.1
Energizer Holdings ENR (9)	3792.4	66	33	21.2 b	114.8	1668	16	1.2	NA	1.8	0.00	3.82	4.14 *	4.63	9.0
Kimberly-Clark KMB	30423.3	66	11	2.9	23.5	510	22	1.9	13.0	2.3	2.95	3.31	3.89	4.19	7.5
Procter & Gamble PG (6)	198966.1	63	8	17.4 b	14.4	313	24	2.8	16.2	2.2	1.97	2.53	2.64 *	3.02	11.0
Spectrum Brands SPC (9)	456.1	9	-56	NA	-48.7	52	NM	0.2	NM	NM	0.00	0.91	-8.66 *	0.64	14.0
(B) PERSONAL PRODUCTS															
INDUSTRY COMPOSITE	**8526.7**	**37**	**54**	**12.9**	**27.3**	**770**	**27**	**1.4**	**18.0**	**2.2**	**1.12**	**1.58**	**1.38**	**1.89**	**12.7**
Avon Products AVP	14510.1	33	14	18.4	48.5	1476	31	1.7	22.7	2.9	2.14	1.81	1.03	1.61	11.0
Estee Lauder EL (6)	8626.8	41	23	16.8 b	20.2	543	28	1.3	16.8	2.3	1.21	1.80	1.49 *	2.08	12.0

TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
TY (9)	2443.2	36	124	3.5 b	13.3	291	22	1.3	14.6	1.5	0.00	1.13	1.62 *	1.98	15.0	B
COMPOSITE	26922.1	51	17	33.6	25.6	327	15	1.7	9.8	1.3	0.78	3.33	4.10	4.43	16.0	
RY GROUP COMPOSITE	**26922.1**	**51**	**17**	**33.6**	**25.6**	**327**	**15**	**1.7**	**9.8**	**1.3**	**0.78**	**3.33**	**4.10**	**4.43**	**16.0**	
ERGY EQUIPMENT & SERVICES																
RY COMPOSITE	17124.7	49	12	23.2	26.9	394	17	2.4	12.2	0.7	0.37	1.83	3.08	4.12	25.4	
ghes BHI	23688.5	73	21	19.2	44.9	456	11	2.8	8.6	0.8	0.71	2.56	4.27	5.24	22.3	B
ces BJS (9)	10243.7	34	-8	48.4 b	34.9	444	13	2.3	10.5	0.7	0.59	1.38	2.52 *	3.04	20.0	B
n International CAM	6038.8	54	31	15.0	16.7	364	23	1.8	17.1	1.0	0.00	1.52	2.81	3.77	20.0	B
hnologies FTI	4074.7	60	40	29.1	23.7	477	21	1.1	15.7	0.8	0.00	1.50	3.18	3.89	25.0	NR
on HAL	33908.7	34	9	37.2	38.2	478	13	1.5	10.5	0.8	0.89	2.27	2.14	2.56	20.5	B
ndustries NBR	9348.2	34	-11	15.6	30.3	285	11	2.1	6.8	0.3	0.00	2.00	3.71	4.70	34.0	B
Oilwell Varco NOV	11672.1	67	6	9.3	11.5	245	21	1.8	16.8	0.7	0.00	1.81	3.60	4.74	26.5	B
s International OIS	1725.8	35	10	26.9	23.6	215	9	0.9	7.1	NA	0.00	2.41	3.68	3.71	NA	NR
n-UTI Energy PTEN	4429.4	28	-16	20.8	43.4	295	7	1.8	5.3	0.4	1.16	2.15	4.13	3.93	19.0	B-
ernational PDE	5297.6	32	5	8.4	10.6	209	21	2.2	10.1	0.5	0.00	0.80	1.69	3.68	34.9	B-
erger SLB	80684.2	68	41	27.3	33.8	841	26	4.5	18.2	0.9	0.73	1.81	2.96	3.74	25.0	B
ternational SII	8445.9	42	14	16.3	24.2	457	19	1.2	14.4	1.0	0.76	1.48	2.47	3.04	16.7	B
an RIG	23063.1	78	12	27.7	14.2	357	28	6.7	17.5	0.7	0.00	2.13	2.86	7.47	40.3	B-
. GAS & CONSUMABLE FUELS																
RY COMPOSITE	30460.1	52	19	38.5	25.1	303	14	1.5	9.0	1.6	0.92	3.88	4.47	4.55	12.4	
Energy ALJ	1457.5	31	58	51.2	60.0	529	9	0.5	7.6	NA	0.51	2.61	3.01	2.78	NA	NR
tural Resources ANR	1039.0	16	-18	NA	26.9	362	13	0.5	5.0	0.6	0.00	0.38	1.39	1.67	20.0	NR
o Petroleum APC	22694.2	49	4	NM	25.3	165	7	2.5	4.8	0.8	0.73	5.20	5.78	6.56	11.2	B+
APA	23035.8	70	2	34.9	22.3	184	8	2.8	5.1	1.1	0.86	7.84	7.64	8.18	8.0	B+
il ACI	5097.9	36	-10	23.6	13.5	384	29	2.0	13.0	0.7	0.67	0.18	1.67	2.67	30.0	B-
ake Energy CHK	14855.9	34	7	13.5	18.7	180	8	2.1	4.5	0.8	0.71	2.51	3.42	3.21	12.7	B-
CVX	157656.4	72	27	132.6 a	25.2	227	9	0.7	6.4	1.3	2.88	6.54	8.05	7.58	6.9	B+
hillips COP	110760.3	67	16	37.2	20.0	138	6	0.6	4.8	1.0	2.14	9.63	10.08	9.41	7.0	B+
nergy CNX	6703.4	37	13	34.4	29.8	541	19	1.9	10.2	0.7	0.76	3.13	2.10	2.75	25.9	NR
Energy XTXI	1486.4	97	54	NM	21.1	515	21	0.4	11.2	4.8	2.64	3.79	1.04	1.41	19.5	NR
Holdings DK	867.2	17	NA	NA	28.6	234	7	0.3	6.9	0.7	0.22	1.64	2.02	1.71	13.0	NR
ergy DVN	32429.6	73	17	234.5	18.7	188	10	2.9	5.8	1.4	0.61	6.26	6.52	7.75	8.0	B+
P	10161.4	15	20	NM	7.2	255	32	2.1	6.8	2.0	1.10	-1.13	0.92	1.20	8.0	B-
ources EOG	17170.6	71	-4	NA	27.6	319	11	4.1	7.2	1.5	0.34	5.13	4.84	5.18	10.0	B
bil XOM	447993.1	77	37	27.4	34.3	384	12	1.3	8.8	1.5	1.67	5.71	6.39	6.23	8.0	A-
Oil FTO	3502.1	32	69	24.7	56.0	507	9	0.7	8.2	1.5	0.38	2.42	3.33	2.62	6.2	B
ustries GI	1128.5	77	48	49.4	22.3	234	11	0.3	7.5	NA	0.00	7.63	5.87	6.99	NA	B-
S	14133.8	50	19	6.9	25.4	183	8	0.5	4.4	1.2	0.80	3.98	5.79	6.02	7.2	B
C	3022.1	54	83	21.9	51.4	653	13	0.8	11.0	NA	0.59	2.64	4.18	3.60	NA	B+
organ KMI	14064.2	105	14	24.2	15.8	335	21	1.5	12.0	1.8	3.33	4.43	4.99	5.32	12.0	B
Oil MRO	33392.6	94	55	16.9	35.7	231	7	0.5	5.0	0.6	1.70	8.49	12.74	10.38	11.5	B+
nergy MEE	2222.6	28	-27	NM	-24.5	305	NM	1.0	43.1	6.9	0.58	-1.33	0.30	1.60	13.3	NR
il MUR	10153.5	54	1	28.6	17.4	250	15	0.7	9.2	1.3	1.11	4.46	3.39	3.73	12.2	B+
Exploration NFX	6417.3	50	-1	21.1	23.5	218	9	3.8	5.2	0.9	0.00	2.73	3.87	5.00	15.0	B
ergy NBL	9366.0	54	33	53.1	18.0	229	13	3.4	7.2	1.6	0.56	4.12	4.91	5.48	7.0	B
al Petroleum OXY	42340.1	50	26	60.5 a	24.7	225	9	2.4	6.5	1.1	1.75	6.45	5.27	5.08	8.6	B+
Energy BTU	12125.7	46	12	47.6 a	24.8	512	21	2.4	13.0	0.6	0.52	1.58	2.23	3.09	36.7	NR
atural Resources PXD	5310.0	44	-15	36.1	9.6	179	20	2.9	7.7	2.4	0.60	3.02	1.86	2.89	9.6	B
UN	8391.7	68	-13	30.6	53.8	395	8	0.2	5.3	0.7	1.47	7.08	7.66	7.04	12.4	A-
O	4796.9	70	14	36.1	29.4	198	7	0.3	5.0	1.6	0.57	7.20	10.69	7.88	4.1	B
U	1085.5	12	4	-28.0	9.8	111	11	0.6	8.3	NA	0.00	0.26	0.82	0.38	NA	NR
ergy VLO	33377.4	55	7	28.9	32.0	187	6	0.3	4.9	2.2	0.58	6.10	8.07	7.03	3.1	B+
efining WNR	1886.8	28	NA	NA	46.5	393	8	0.5	8.1	2.6	0.56	NA	2.66	2.39	4.1	NR
WMB	16547.7	28	20	-19.8	4.1	273	69	1.3	15.5	1.7	1.30	0.53	1.09	1.48	15.0	B
l Services INT	1375.1	49	44	18.4	14.4	338	24	0.1	22.0	NA	0.31	1.57	2.23	2.72	NA	A-
gy XTO	18515.8	51	15	31.3	34.3	337	10	4.1	6.8	0.7	0.71	3.15	4.17	4.70	17.6	B+
LS																
COMPOSITE	25102.2	1007	10	22.5	14.2	659	16	2.1	12.5	1.6	2.22	53.10	54.50	54.14	10.8	
KS																
S / GROUP COMPOSITE	**22050.0**	**47**	**6**	**18.4**	**14.1**	**188**	**14**	**2.3**	**10.9**	**1.5**	**3.20**	**3.46**	**3.58**	**3.85**	**9.6**	
MERCIAL BANKS																
S / COMPOSITE	23168.1	48	6	18.0	14.2	197	14	2.4	11.3	1.6	3.30	3.30	3.44	3.67	9.4	
T	23253.4	43	3	9.1	14.5	198	14	2.6	11.7	1.4	3.91	3.00	3.18	3.40	9.8	A-
CMA	9252.6	58	3	7.1	15.4	178	12	2.3	NA	1.5	4.05	5.11	4.84	4.98	8.0	A
e Bancorp CBH	6504.6	35	1	20.6	10.4	240	23	2.4	NA	1.4	1.38	1.61	1.63	1.86	15.0	A+

COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
Compass Bancshares CBSS	7410.1	57	18	10.4	16.2	270	17	2.8	13.5	1.6	2.73	3.18	3.53	3.84	10.0
Fifth Third Bancorp FITB	22004.5	39	5	13.0	14.5	220	15	2.6	NA	1.9	4.06	2.77	2.08	2.86	10.0
First Horizon National FHN	4961.3	40	4	8.4	11.5	198	18	1.4	12.2	1.8	4.52	3.42	2.72	2.84	8.0
Huntington Bancshares HBAN	5783.9	24	2	34.6	15.1	185	12	2.3	9.4	1.9	4.11	1.77	1.82	1.88	7.0
KeyCorp KEY	14539.2	36	10	64.8	15.1	183	12	1.9	NA	1.6	3.82	2.73	2.94	3.03	7.5
M&T Bank MTB	13119.9	119	9	17.1	13.5	213	16	3.1	13.1	1.6	2.02	6.73	7.37	7.96	10.0
Marshall & Ilsley MI	11668.5	46	6	18.9	13.2	196	14	2.4	NA	1.4	2.36	3.10	3.20	3.50	10.0
National City NCC	21727.7	36	8	8.0	14.4	168	12	1.8	8.8	1.4	4.32	3.09	3.14	3.03	8.0
PNC Financial Services Group PNC	20782.9	71	14	37.9	23.9	193	8	2.3	NA	1.4	3.11	4.55	5.04	5.59	10.0
Popular BPOP	4930.4	18	-16	15.8	11.5	143	12	1.3	8.7	2.2	3.62	1.96	1.33	1.36	6.0
Regions Financial RF	16678.2	37	7	4.3	11.3	151	14	2.5	12.2	1.6	3.82	2.15	2.88	2.93	8.0
SunTrust Banks STI	29709.8	82	12	3.8	11.5	164	14	2.3	NA	1.5	2.99	5.47	5.88	6.26	9.0
Synovus Financial SNV	9750.9	30	11	11.8	16.2	274	17	2.5	NA	1.2	2.60	1.64	1.86	1.98	13.0
TD Banknorth BNK	7345.9	32	11	-2.0	3.8	89	22	3.3	14.2	1.5	2.73	1.55	2.14	2.16	10.1
U.S. Bancorp USB	59312.5	34	13	32.3	22.3	298	13	3.2	NA	1.3	3.92	2.42	2.62	2.81	10.0
UnionBanCal UB	8077.2	58	-16	14.7	15.0	174	12	2.4	NA	1.7	3.27	4.94	4.77	4.62	7.0
Wachovia WB	85674.4	54	3	29.3	13.6	167	12	2.0	10.0	1.2	4.13	4.05	4.68	5.03	9.5
Wells FargoWFC	118854.1	35	12	22.9	18.3	265	15	2.6	10.2	1.4	3.18	2.25	2.49	2.74	10.1
Zions Bancorporation ZION	8356.4	78	4	12.3	12.2	180	15	2.7	12.0	1.4	1.99	5.16	5.54	6.07	10.0
(B) THRIFTS & MORTGAGE FINANCE															
INDUSTRY COMPOSITE	**17130.2**	**42**	**9**	**20.7**	**13.3**	**148**	**13**	**2.0**	**9.9**	**1.2**	**2.74**	**4.17**	**4.20**	**4.64**	**10.8**
Countrywide Financial CFC	24497.3	40	16	36.4 a	17.8	162	9	1.1	6.9	0.8	1.51	4.11	4.33	4.82	12.0
IndyMac Bancorp NDE	3255.9	46	18	NA	17.7	168	9	1.4	6.7	0.6	4.35	4.54	5.20	5.57	14.0
MGIC Investment MTG	4810.4	58	-12	3.4	13.5	114	9	3.3	8.1	0.9	1.73	6.78	6.70	7.20	9.9
Sovereign Bancorp SOV	11805.7	25	21	40.8	4.9	138	24	2.8	18.8	2.3	1.28	1.69	1.38	1.50	8.0
Washington Mutual WM	41281.9	44	0	2.0	12.6	159	13	1.6	9.0	1.3	4.85	3.73	3.39	4.10	10.0
11 DIVERSIFIED FINANCIALS															
INDUSTRY GROUP COMPOSITE	**46275.9**	**80**	**16**	**24.6**	**17.7**	**2098**	**18**	**3.1**	**15.1**	**1.4**	**1.35**	**3.73**	**4.75**	**5.20**	**12.6**
(A) CAPITAL MARKETS															
INDUSTRY COMPOSITE	26949.5	69	21	24.9	16.4	283	18	2.5	15.2	1.4	1.17	3.62	4.77	5.12	12.6
Ameriprise Financial AMP	13098.3	54	32	NA	7.4	169	24	1.7	NA	1.6	0.81	2.26	3.26	3.65	10.5
Bank of New York BK	27152.3	36	12	2.9	13.9	259	19	3.1	14.1	1.5	2.48	2.03	2.25	2.41	10.8
Bear Stearns BSC (11)	18076.7	152	32	24.4	16.0	159	12	1.2	8.1	1.0	0.73	10.31	13.54	13.81	11.0
E*Trade Financial ET	10278.1	24	15	NM	14.3	255	18	2.9	14.3	0.9	0.00	1.16	1.47	1.73	17.5
Edwards (A.G.) AGE (2)	4403.3	58	23	36.6	13.8	219	16	1.5	NA	1.5	1.38	3.06	3.75	4.21	10.0
Franklin Resources BEN (9)	27031.8	107	14	31.4 b	18.9	404	22	5.4	20.5	1.5	0.45	4.06	4.86 *	6.11	14.6
Goldman Sachs Group GS (11)	83551.7	195	53	27.4	23.6	275	12	1.3	9.6	0.7	0.72	11.21	18.58	17.56	15.0
Jefferies Group JEF	3446.2	29	29	19.4	13.1	231	21	1.8	15.9	2.1	1.72	1.16	1.38	1.55	10.0
Legg Mason LM (3)	12732.5	95	-20	36.3	8.9	205	24	3.3	19.2	1.6	0.88	3.35	4.39	5.26	14.0
Lehman Brothers Holdings LEH (11)	39067.0	74	15	25.5	20.2	226	12	0.9	9.2	0.9	0.65	5.44	6.72	6.97	12.6
Mellon Financial MEL	16569.2	40	17	24.4	19.1	369	19	2.8	16.4	1.8	2.19	2.18	2.14	2.44	10.5
Merrill Lynch MER	76936.3	87	29	NM	16.5	217	13	1.2	10.9	1.2	1.14	5.16	5.88	7.20	12.4
Morgan Stanley MS (11)	81522.3	76	34	10.5	20.6	246	11	1.1	NA	0.9	1.42	4.81	6.71	6.86	12.8
Northern Trust NTRS	12416.7	57	10	5.8	16.3	315	20	2.9	16.6	1.6	1.76	2.64	3.00	3.39	12.0
Price (T. Rowe) Group TROW	11415.9	43	20	20.0	22.0	504	24	6.6	21.0	1.9	1.29	1.58	1.86	2.20	12.0
Raymond James Financial RJF (9)	3667.7	32	25	26.9 b	14.6	251	17	1.4	16.1	1.7	1.02	1.33	1.85 *	2.04	10.0
Schwab (Charles) SCHW	23139.3	18	25	72.0 a	20.4	499	25	3.9	20.4	1.3	1.09	0.56	0.80	0.93	18.1
State Street STT	20586.0	62	12	10.4	14.8	293	20	2.3	NA	1.5	1.29	2.82	3.41	3.78	12.0
(B) CONSUMER FINANCE															
INDUSTRY COMPOSITE	28967.4	51	-5	19.8	25.0	358	14	1.9	9.3	1.1	0.84	3.52	3.93	4.38	13.4
American Express AXP	70698.9	59	14	26.5	33.1	657	21	2.5	NA	1.5	1.02	2.56	3.03	3.39	13.0
AmeriCredit ACF (6)	2697.0	23	-9	-12.2 b	18.9	157	10	1.4	7.5	0.9	0.00	1.73	2.08 *	2.60	12.7
Capital One Financial COF	23708.7	78	-10	23.3	13.8	142	10	1.6	8.4	0.8	0.14	6.73	7.77	8.18	13.0
SLM SLM	18765.1	46	-17	41.5	34.1	477	13	2.1	12.0	1.1	2.18	3.05	2.86	3.35	15.1
(C) DIVERSIFIED FINANCIAL SERVICES															
INDUSTRY COMPOSITE	115794.1	134	16	27.9	16.7	8704	22	5.8	17.8	1.6	2.24	4.22	5.23	5.99	12.2
Bank of America BAC	242225.1	54	17	15.1	14.6	182	12	2.2	11.0	1.3	4.16	4.04	4.67	4.94	9.0
Chicago Mercantile Exchange CME	18629.8	536	46	36.1	26.8	1311	49	17.3	41.3	2.2	0.47	8.81	11.59	14.68	21.1
CIT Group CIT	10322.9	52	0	NM	13.3	146	11	1.6	5.1	1.3	1.54	4.44	4.97	5.30	7.9
Citigroup C	243668.6	50	2	NA	17.8	209	12	1.8	10.4	1.2	3.95	3.82	4.30	4.57	10.0
JPMorgan Chase JPM	160477.3	46	17	31.3	11.0	141	13	1.7	10.0	1.3	2.94	2.38	3.69	3.96	10.0
Moody's MCO	19440.7	69	13	29.2	NM	50234	33	10.1	29.3	2.1	0.40	1.84	2.19	2.48	15.0
12 INSURANCE															
INDUSTRY GROUP COMPOSITE	**17669.1**	**2242**	**8**	**23.8**	**12.7**	**156**	**14**	**1.3**	**11.4**	**1.2**	**1.57**	**115.96**	**120.63**	**119.44**	**10.9**
ACE ACE	18527.4	57	6	NM	13.5	137	10	1.4	9.9	0.7	1.72	3.31	6.98	6.83	12.0
AFLAC AFL	21834.5	44	-5	24.4	18.9	272	15	1.5	NA	1.0	1.68	2.92	2.87	3.27	15.0
Allstate ALL	39802.0	63	17	13.2	21.7	179	8	1.1	NA	0.9	2.21	2.64	7.68	6.93	9.0

TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
inancial Group ABK	9094.4	86	11	14.7	14.6	151	10	5.0	NA	0.9	0.84	6.87	7.64	7.81	13.0	A+
Financial Group AFG	4130.6	52	36	NM	14.0	150	11	1.0	7.3	1.2	1.05	2.64	4.64	4.94	9.5	B
International Group AIG	182777.1	70	3	25.9	11.5	190	17	1.7	13.4	0.9	0.94	3.99	5.87	6.26	13.0	A+
:	11049.2	36	-1	37.4	10.8	206	21	1.2	13.6	2.0	1.68	1.89	2.22	2.67	8.0	B+
AIZ	6840.3	55	26	40.4	16.0	182	12	0.9	NA	1.2	0.73	3.50	4.68	4.92	10.0	NR
W.R.) BER	6726.1	35	11	NM	21.6	217	11	1.3	9.0	0.8	0.46	2.72	3.36	3.57	13.5	B
Hathaway BRK.A	165148.2	107100	21	80.6	12.3	162	13	1.7	NA	NA	0.00	5538	5667	5603.67	NA	B
B	21306.8	52	6	94.1	18.3	157	9	1.5	8.3	0.9	1.93	4.47	5.47	5.19	10.0	B+
i Financial CINF	7660.4	44	-1	33.2	15.2	119	8	1.7	NA	1.5	3.03	3.40	2.84	3.07	10.5	A-
ncial CNA	10430.8	39	18	NM	5.3	112	20	1.1	17.3	0.7	0.00	0.68	3.98	4.01	13.0	B-
e Group CGI	2068.2	31	7	32.1	16.6	140	8	1.1	NA	NA	3.28	3.61	3.49	3.06	NA	A-
CNO	3021.8	20	-14	NA	2.8	75	24	0.7	5.1	1.4	0.00	1.76	1.44	1.65	10.0	NR
e Group RE	6396.7	98	-2	NM	9.8	133	14	1.5	13.5	0.7	0.61	-3.79	12.69	12.49	11.1	A-
ational Financial FNF	3946.7	23	-7	NA	16.1	150	9	0.7	7.3	1.3	5.30	3.11	1.93	1.95	9.0	NR
rican FAF	3698.8	39	-15	21.6	9.7	117	12	0.4	7.4	1.0	1.86	4.97	3.69	3.69	10.0	B+
(Arthur J.) AJG	2873.3	29	-5	-31.5	13.2	340	26	1.9	17.5	1.8	4.10	0.30	1.49	1.77	11.0	A
Financial GNW	14825.6	33	-5	-3.7 a	9.5	111	12	1.4	NA	1.2	1.10	2.52	2.81	3.14	10.0	NR
nsurance Group THG	2411.6	47	13	NA	11.9	126	11	0.9	9.7	1.0	0.63	1.42	3.74	4.23	12.5	B-
Financial Services Group HIG	27151.8	86	0	35.0	13.7	153	11	1.0	NA	0.8	2.33	7.44	8.96	9.58	11.5	B
rica Financial GroupLFG	1087.4	61	-2	26.4	9.1	80	9	0.3	6.0	1.4	1.44	9.29	5.40	6.21	8.0	B
ational LNC	17636.0	64	20	12.7	9.6	146	13	2.3	14.1	1.1	2.48	4.72	5.03	5.39	12.0	B+
R	22208.9	40	26	NM	11.6	138	15	1.4	NA	1.4	0.63	1.69	3.57	4.03	8.0	B-
KL	4326.2	448	41	NM	20.0	219	11	1.8	NA	1.2	0.00	14.80	32.05	30.99	11.5	B-
McLennan MMC	17297.7	31	-1	-20.4	9.8	279	29	1.5	16.3	2.1	2.16	0.67	1.53	1.85	10.0	A-
I	9389.0	70	16	9.4 a	11.6	133	12	3.6	NA	1.0	1.78	5.19	5.99	6.26	12.0	A
General MCY	2922.9	53	-8	24.3	12.4	173	14	0.9	12.5	1.8	3.59	4.63	3.98	4.44	7.5	B+
IET	44633.8	59	20	78.6	8.7	141	16	0.9	NA	1.1	1.00	4.07	5.04	5.28	10.8	NR
le Financial Services NFS	7784.4	52	18	5.2	12.7	138	11	1.8	NA	1.4	1.77	4.06	4.69	4.23	8.0	B+
te Holdings ORH	2491.6	35	41	NM	16.8	124	8	0.9	7.3	0.7	0.35	-1.62	3.35	2.90	15.0	NR
alty OCAS	1785.9	29	3	18.1	14.9	121	9	1.1	7.5	1.1	1.23	3.19	2.57	2.57	10.0	B-
lic International ORI	5197.3	23	7	11.4	11.7	121	10	1.3	NA	1.1	2.66	2.37	1.99	2.03	10.0	A-
PRE	3962.2	70	6	NM	12.4	112	9	1.0	8.4	0.6	2.29	-1.56	10.14	8.40	12.0	B
NX	1835.3	16	18	NM	4.8	83	17	0.7	NA	1.9	0.99	1.06	0.70	0.97	12.0	NR
Financial Group PFG	15569.4	58	22	44.6	12.8	203	16	1.6	13.8	1.4	1.39	3.02	3.46	3.82	12.0	NR
ve PGR	17176.3	23	-23	39.8	22.8	256	12	1.2	10.6	1.3	0.16	1.75	2.10	1.91	8.6	B+
Life PL	3302.3	47	8	14.5	11.7	145	13	1.4	11.9	1.4	1.82	3.46	3.49	4.27	9.5	A
l Financial PRU	38890.6	81	11	NA	11.7	168	15	1.2	NA	1.0	1.17	6.46	5.97	6.63	13.7	NR
ce Group of America RGA	3385.6	55	16	46.6	10.1	122	12	0.7	NA	1.1	0.65	3.70	4.54	4.97	11.2	B+
Insurance Group SIGI	1592.7	56	5	49.9	15.5	152	11	0.9	8.5	1.2	1.59	4.65	4.56	4.77	10.0	B+
avelers STA	35723.0	52	16	-1.9	12.9	145	12	1.4	8.9	0.9	2.01	2.95	5.62	5.56	10.0	NR
Financial Group SFG	2432.9	45	-9	21.6	13.3	166	13	1.0	NA	1.2	1.43	3.76	3.47	4.16	11.0	NR
TMK	6212.4	63	14	11.1	14.9	185	13	1.9	NA	1.3	0.82	4.68	4.98	5.45	9.8	A
tic Holdings TRH	4082.2	62	-8	18.4	11.5	144	13	1.0	12.5	0.7	0.87	0.57	6.27	6.42	15.0	B
R	3284.0	49	9	-10.0	13.7	146	11	1.1	10.7	1.3	3.60	3.67	3.79	3.80	10.0	B
ident UNM	7015.3	20	-10	-7.2	3.6	92	24	0.7	14.9	1.2	1.46	1.64	1.74	1.84	10.0	B-
XL	12837.7	71	6	NM	4.5	135	48	1.3	27.1	0.7	2.14	-9.14	9.26	8.96	11.7	B-
ESTATE																
GROUP COMPOSITE	**8853.9**	**42**	**22**	**25.6**	**12.6**	**331**	**26**	**2.8**	**12.8**	**5.3**	**5.53**	**2.07**	**2.06**	**1.78**	**7.9**	
ESTATE INVESTMENT TRUSTS																
COMPOSITE	9386.0	45	15	5.4	10.3	293	28	3.1	9.0	6.3	7.10	2.26	2.22	1.83	6.6	
ce Properties Trust EOP	16930.1	48	59	-21.9	-1.1	275	NM	5.1	NA	21.0	2.74	0.38	0.58	0.44	4.0	B
s & Resorts HST	13132.1	25	33	NA	3.6	255	56	2.9	NA	1.1	3.17	0.30	1.49	0.93	15.5	B-
ry Financial NEW	1995.2	36	0	46.9	18.5	97	5	0.7	NA	1.0	21.08	7.17	6.09	4.18	6.0	B
k Timber PCL	6595.0	37	3	-8.7	14.7	314	22	4.0	NA	4.4	4.29	1.79	1.69	1.74	5.0	NR
CH	1615.4	42	-18	NM	15.8	243	14	1.0	8.2	7.2	4.70	1.13	1.15	1.29	5.0	B
perty Group SPG	22567.2	102	33	NA	9.1	744	60	6.6	NA	7.2	2.98	NA	2.02	1.96	7.0	B+
Mortgage TMA	2867.2	25	-4	NA	11.7	126	10	1.3	9.9	2.5	10.76	2.79	2.49	2.27	4.0	B+
ESTATE MANAGEMENT & DEVELOPMENT																
COMPOSITE	6991.4	30	68	86.2	20.5	464	21	1.6	16.7	1.6	0.00	0.95	1.51	1.60	12.5	
d Ellis Group CBG	7418.6	33	68	86.2 a	28.2	723	26	2.2	21.6	1.8	0.00	0.95	1.47	1.90	12.5	NR
	6564.2	26	NA	NA	12.8	204	16	1.0	11.7	1.4	0.00	NA	1.55	1.31	12.5	NR
ARE																
OMPOSITE	21918.9	46	7	23.5	14.4	385	31	2.6	69.4	1.5	0.58	1.76	2.29	2.63	14.6	
HEALTHCARE EQUIPMENT & SERVICES																
GROUP COMPOSITE	**10545.7**	**45**	**5**	**21.5**	**14.3**	**328**	**22**	**1.5**	**14.7**	**1.4**	**0.34**	**1.84**	**2.32**	**2.69**	**14.3**	
HEALTH CARE EQUIPMENT & SUPPLIES																
COMPOSITE	14719.8	47	0	15.3	14.1	395	26	3.1	18.2	1.6	0.66	1.52	2.18	2.43	13.8	

COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
Bard (C.R.) BCR	8474.5	82	25	22.6	19.2	492	27	4.4	21.1	1.8	0.68	3.12	3.28	3.81	14.0
Baxter International BAX	29280.8	45	19	8.7	19.9	462	23	2.9	16.0	1.6	1.30	1.52	2.19	2.48	13.0
Beckman Coulter BEC	3691.6	59	4	1.2	8.8	286	33	1.5	NA	1.5	1.01	2.32	2.81	3.21	14.0
Becton, Dickinson BDX (9)	17549.3	72	19	13.3 b	21.2	493	24	3.0	16.0	2.0	1.37	2.66	2.95 *	3.71	12.0
Biomet BMET (5)	9255.5	38	3	16.7	23.3	528	23	4.5	18.7	1.4	0.79	1.63	1.82	2.07	15.0
Boston Scientific BSX	23352.3	16	–35	NM	–23.4	156	NM	3.2	NM	2.0	0.00	0.75	0.77	0.76	10.1
Dade Behring Holdings DADE	3246.5	38	–7	NA	15.0	361	25	1.9	11.2	1.7	0.53	1.36	1.50	1.63	15.0
Dentsply International XRAY	4920.4	32	19	–21.7	12.3	383	32	2.8	24.0	1.5	0.50	0.28	1.41	1.58	15.0
Hillenbrand Industries HB (9)	3550.1	58	17	41.4 b	20.6	331	16	1.8	NA	1.6	1.95	–1.56	3.60 *	3.16	10.0
Hospira HSP	5109.0	33	–23	–4.4	16.5	388	24	1.9	13.8	1.7	0.00	1.46	1.94	2.08	10.0
Invacare IVC	745.9	23	–26	8.0	3.3	91	28	0.5	11.3	NA	0.21	1.51	1.15	1.23	NA
Medtronic MDT (4)	59949.5	52	–9	27.1	26.2	583	23	5.1	18.5	1.6	0.84	2.09	2.36	2.69	14.0
St. Jude Medical STJ	13169.2	37	–26	20.7	14.4	477	35	4.1	27.0	1.7	0.00	1.04	1.50	1.72	15.0
Stryker SYK	21101.8	52	17	25.1	18.4	529	29	4.0	23.6	1.3	NA	1.64	2.02	2.41	20.0
Zimmer Holdings ZMH	17401.0	73	8	39.7	16.4	362	23	5.1	17.7	1.3	0.00	2.93	3.40	3.90	16.4
(B) HEALTH CARE PROVIDERS & SERVICES															
INDUSTRY COMPOSITE	9032.1	45	7	23.7	14.4	301	20	0.8	13.5	1.3	0.23	1.99	2.41	2.82	14.6
Aetna AET	21563.8	41	–12	NM	17.4	223	14	0.9	11.2	1.0	0.10	2.70	2.81	3.25	15.5
Amerigroup AGP	1780.2	34	76	–0.5	12.3	243	20	0.7	15.3	1.8	0.00	1.02	1.30	1.82	14.9
AmerisourceBergen ABC (9)	9254.7	46	11	9.5 b	11.3	223	20	0.2	16.7	1.6	0.43	1.37	2.26 *	2.48	13.0
Apria Healthcare Group AHG	1060.2	25	4	1.5	18.9	273	15	0.7	5.0	1.2	0.00	1.37	1.70	1.79	12.0
Cardinal Health CAH (6)	26222.8	65	–6	3.7 b	15.5	311	21	0.3	15.4	1.7	0.56	2.54	2.90 *	3.64	13.5
Caremark Rx CMX	19900.5	47	–9	29.5	14.2	266	20	0.6	16.4	1.1	0.85	2.05	2.41	2.83	18.0
Centene CNC	1125.0	26	–1	23.1	–14.3	368	NM	0.6	NM	1.8	0.00	1.24	1.01	1.54	14.5
Cigna CI	12928.7	126	13	12.4	26.7	304	13	0.8	9.6	1.2	0.08	9.83	9.20	10.25	11.0
Community Health Systems CYH	3329.5	35	–9	44.0	9.9	195	20	0.8	9.5	1.1	0.00	2.02	2.20	2.34	15.0
Coventry Health Care CVH	7669.9	48	–16	54.1	19.1	276	15	1.0	12.0	1.0	0.00	3.10	3.47	3.92	14.0
DaVita DVA	5531.3	53	5	20.3	23.7	482	21	1.2	12.5	1.1	0.00	1.99	2.50	3.16	20.0
Emergency Medical Services EMS	732.7	18	32	NA	9.1	195	21	0.4	7.4	1.3	0.00	NA	0.91	1.08	15.0
Express Scripts ESRX	9236.8	68	–19	36.1	45.1	952	23	0.5	17.2	1.2	0.00	2.68	3.26	3.95	17.0
Genesis HealthCare GHCI (9)	907.8	46	27	NA	5.4	130	24	0.5	9.0	1.7	0.00	2.31	1.93 *	2.50	14.5
Health Management Associates HMA	4941.2	21	–7	17.3	12.2	199	17	1.3	10.0	1.2	1.17	1.42	1.24	1.35	13.3
Health Net HNT	5376.3	46	–10	32.3	16.8	281	17	0.4	15.6	1.1	0.00	1.99	3.03	3.54	14.0
Healthsouth HLS	1898.6	24	–3	NM	NM	NM	NM	0.6	NA	NM	0.00	–4.85	–0.23	0.13	NA
Humana HUM	8992.9	54	0	27.8	13.7	311	23	0.5	16.7	1.1	0.00	1.87	2.77	3.88	18.2
Kindred Healthcare KND	1025.9	26	0	7.4 a	8.4	116	14	0.2	5.3	1.7	0.00	2.84	1.56	1.49	10.0
Laboratory Corp. of America Holdings LH	8878.3	71	31	21.1	19.4	414	23	2.5	15.5	1.7	0.00	2.71	3.18	3.89	13.0
LifePoint Hospitals LPNT	1991.1	35	–7	14.4	9.3	142	15	0.8	8.2	1.0	0.00	1.56	2.38	2.64	14.0
Magellan Health Services MGLN	1659.5	44	40	49.2	15.9	228	15	1.0	10.2	1.5	0.00	3.42	2.13	2.33	13.5
Manor Care HCR	3516.5	48	19	30.1	24.6	571	25	1.0	11.9	1.4	1.35	1.89	2.33	2.73	15.0
McKesson MCK (3)	14622.4	49	–4	13.1	14.9	247	17	0.2	12.6	1.4	0.49	2.34	2.76	3.14	13.0
Medco Health Solutions MHS	14779.3	50	–10	21.2	7.7	196	27	0.3	15.2	1.2	0.00	2.05	2.69	3.16	15.0
Molina Healthcare MOH	913.3	34	28	–9.5	11.0	225	21	0.5	14.2	1.5	0.00	0.98	1.65	2.09	13.8
Omnicare OCR	4819.4	40	–31	27.7	5.2	154	29	0.7	21.9	1.0	0.23	2.10	2.63	2.98	15.0
Owens & Minor OMI	1247.2	31	13	24.0	10.5	229	22	0.2	15.2	1.7	1.93	1.61	1.58	1.97	11.5
Patterson Companies PDCO (4)	5156.6	37	11	19.6	16.2	415	26	1.9	22.8	1.5	0.00	1.43	1.56	1.78	16.0
PSS World Medical PSSI (3)	1417.3	21	41	42.5	13.3	385	29	0.8	20.0	1.3	0.00	0.66	0.78	0.95	20.0
Quest Diagnostics DGX	10494.1	53	3	29.7	19.7	342	18	1.7	NA	1.2	0.75	2.66	3.15	3.22	14.0
Schein (Henry) HSIC	4563.3	52	18	17.0	12.3	324	27	0.9	19.2	1.6	0.00	1.82	2.13	2.55	15.0
Tenet Healthcare THC	3341.6	7	–7	NM	NM	530	NM	0.4	NM	NM	0.00	–1.32	–0.03	0.04	12.0
Triad Hospitals TRI	3741.8	43	8	73.8	7.2	118	16	0.7	8.3	1.2	0.00	2.74	2.51	2.73	14.0
UnitedHealth Group UNH	65914.4	49	–21	37.2	19.6	336	18	1.0	14.8	1.0	0.06	2.48	2.97	3.42	17.0
Universal Health Services UHS	3092.9	55	18	5.5	15.7	207	14	0.8	7.8	1.7	0.58	1.91	2.69	3.07	12.0
WellCare Health Plans WCG	2628.6	65	58	NA	18.7	528	28	0.8	24.2	1.1	0.00	1.32	3.33	3.94	17.8
WellPoint WLP	46961.6	76	–5	24.3	12.2	195	17	0.9	NA	1.1	0.00	3.94	4.79	5.52	15.0
(C) HEALTH CARE TECHNOLOGY															
INDUSTRY COMPOSITE	5451.1	27	10	32.2			17	2.9	12.0	1.6	0.44	1.22	1.40	1.59	12.0
IMS Health RX	5451.1	27	10	32.2	NM	NM	17	2.9	12.0	1.6	0.44	1.22	1.40	1.59	12.0
15 PHARMACEUTICALS, BIOTECHNOLOGY & LIFE SCIENCES															
INDUSTRY GROUP COMPOSITE	**51164.4**	**49**	**12**	**28.4**	**14.5**	**526**	**54**	**5.5**	**189.2**	**1.8**	**1.16**	**1.56**	**2.21**	**2.49**	**15.2**
(A) BIOTECHNOLOGY															
INDUSTRY COMPOSITE	42240.9	65	14	71.2	12.5	874	118	10.8	70.1	1.6	0.00	1.36	2.33	2.73	24.6
Amgen AMGN	82832.6	71	–10	29.9	16.6	467	29	6.0	21.1	1.2	0.00	2.93	3.93	4.41	15.0
Biogen Idec BIIB	17618.3	52	15	–5.5	2.3	256	114	6.8	29.8	2.3	0.00	0.47	2.26	2.55	10.0
Celgene CELG	19624.4	56	72	NM	6.0	2341	429	25.4	268.2	1.9	0.00	0.18	0.53	1.07	54.4
Genentech DNA	86164.6	82	–12	169.9 a	20.9	969	48	10.2	38.3	1.3	0.00	1.18	2.16	2.66	29.3
Genzyme General GENZ	16943.7	64	–9	NA	6.2	293	49	5.5	25.7	1.2	0.00	1.65	2.74	3.14	19.2



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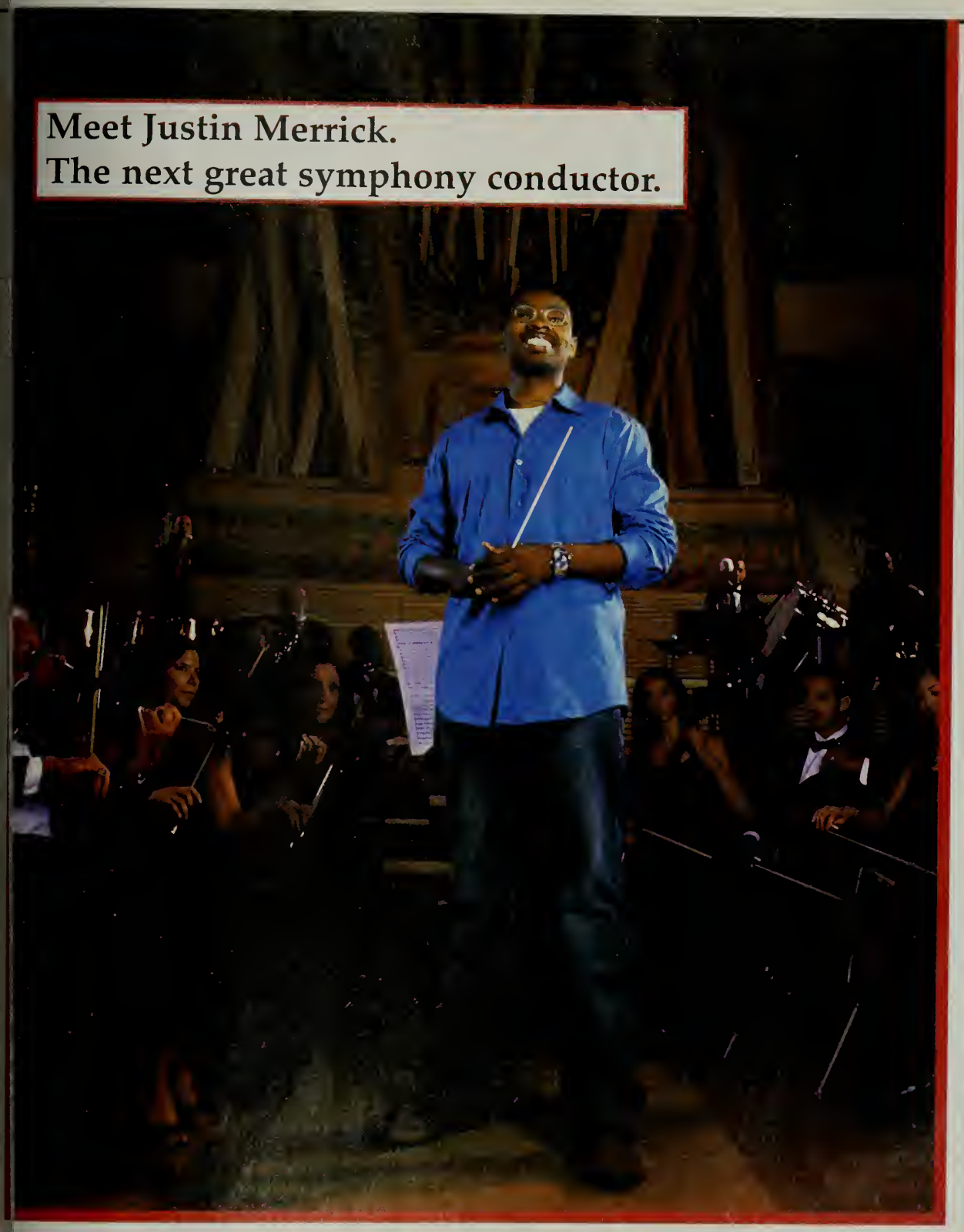
COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
Gilead Sciences GILD	30261.7	66	25	90.7	23.0	917	42	11.1	37.6	1.4	0.00	1.72	2.38	2.55	20.0
(B) PHARMACEUTICALS															
INDUSTRY COMPOSITE	67068.3	45	9	3.4	17.2	412	23	3.6	291.2	2.0	1.89	1.81	2.34	2.57	10.9
Abbott Laboratories ABT	71616.8	47	18	27.4	20.3	458	23	3.2	15.4	1.9	2.53	2.16	2.51	2.80	10.0
Allergan AGN	17657.1	117	8	23.6	-4.1	584	NM	6.2	3331.4	1.8	0.34	3.01	3.65	4.32	17.5
Bristol-Myers Squibb BMY	48840.6	25	8	12.5	19.1	421	22	2.6	15.6	2.9	4.51	1.52	1.04	1.19	8.1
Forest Laboratories FRX (3)	15333.6	49	20	23.0	25.7	541	22	4.9	19.8	1.2	0.00	2.08	2.67	3.02	15.5
Johnson & Johnson JNJ	191423.9	66	10	17.1	27.3	472	18	3.7	14.5	1.8	2.28	3.46	3.74	4.06	10.0
King Pharmaceuticals KG	4018.7	17	-2	-14.3	7.0	179	25	2.1	13.4	2.0	0.00	0.48	1.69	1.44	5.0
Lilly (Eli) LLY	60641.8	54	-5	-8.0	24.9	465	18	4.0	14.8	1.7	2.99	1.83	3.15	3.38	10.0
Merck MRK	96700.6	45	40	-8.8	26.3	501	19	4.3	14.7	3.0	3.41	2.10	2.51	2.54	5.9
Pfizer PFE	198215.0	27	18	-2.0	17.6	285	16	4.0	11.2	2.7	3.49	1.09	2.02	2.14	5.0
Schering-Plough SGP	32640.8	22	6	-45.1	11.6	479	34	3.2	21.4	1.2	1.00	0.12	0.82	1.02	22.0
Watson Pharmaceuticals WPI	2630.3	26	-21	3.4	3.0	121	41	1.5	9.5	1.7	0.00	1.21	1.14	1.41	13.0
Wyeth WYE	65100.0	48	5	11.9	27.5	440	16	3.3	13.1	1.7	2.15	2.70	3.17	3.48	9.0
(C) LIFE SCIENCES TOOLS & SERVICES															
INDUSTRY COMPOSITE	5396.1	34	25	71.6	7.8	288	39	2.5	19.3	1.8	0.59	0.97	1.45	1.67	13.2
Applied Biosystems Group ABI (6)	6610.0	36	37	16.4 b	11.7	447	40	3.4	18.8	2.5	0.47	1.19	1.43 *	1.36	10.0
PerkinElmer PKI	2663.7	22	-8	167.2	4.6	171	39	1.8	19.3	1.4	1.29	0.51	1.12	1.31	14.0
Thermo Fisher Scientific TMO	6914.6	44	45	31.1	7.0	246	37	2.4	19.7	1.6	0.00	1.21	1.81	2.36	15.5
INDUSTRIALS															
SECTOR COMPOSITE	10736.9	46	19	25.7	19.5	344	22	1.0	13.0	1.7	1.00	0.41	2.71	3.19	13.0
16 CAPITAL GOODS															
INDUSTRY GROUP COMPOSITE	**13762.5**	**52**	**22**	**25.7**	**18.6**	**342**	**23**	**1.1**	**14.0**	**1.5**	**1.07**	**1.96**	**3.16**	**3.49**	**13.0**
(A) AEROSPACE & DEFENSE															
INDUSTRY COMPOSITE	21670.6	63	21	50.8	17.4	348	33	1.2	13.9	1.5	1.05	3.09	3.49	4.15	12.9
Alliant Techsystems ATK (3)	2544.9	77	1	18.3	30.6	502	18	0.8	11.3	1.6	0.00	4.11	5.07	5.85	9.4
Armor Holdings AH	2008.9	57	33	58.2	16.4	246	15	1.0	11.5	1.0	0.00	3.70	3.60	5.07	15.0
Boeing BA	67333.8	89	26	-1.6	15.3	611	41	1.2	21.1	2.3	1.36	3.19	2.53	4.73	15.0
DRS Technologies DRS (3)	1995.9	50	-3	17.3	6.8	142	19	0.8	12.4	1.4	0.24	2.67	2.87	3.29	12.0
DynCorp International DCP (3)	746.7	13	NA	NA	1.1	215	218	0.4	14.9	2.4	0.00	NA	0.40	0.99	13.5
General Dynamics GD	30267.5	75	31	12.1	17.5	320	18	1.3	15.0	1.7	1.23	3.63	4.20	4.75	10.3
Goodrich GR	5614.3	45	9	5.5	21.3	268	13	1.0	8.3	0.8	1.78	1.97	3.68	3.06	14.6
Honeywell International HON	35093.6	43	15	NM	17.7	310	18	1.2	12.6	1.4	2.11	1.86	2.52	2.92	12.0
L-3 Communications Holdings LLL	10263.9	82	11	30.0	10.0	203	20	0.9	15.4	1.4	0.91	4.20	4.22	5.70	13.8
Lockheed Martin LMT	38341.4	90	42	153.0	29.3	474	17	1.0	12.3	1.4	1.55	4.10	5.59	5.86	11.8
Northrop Grumman NOC	23100.0	67	11	12.6	8.3	133	16	0.8	10.6	1.4	1.79	3.81	4.43	4.84	10.5
Precision Castparts PCP (3)	10224.8	75	46	39.4	18.2	416	23	2.4	18.5	1.3	0.16	2.57	3.93	4.67	15.0
Raytheon RTN	22677.1	51	27	279.8	10.6	199	19	1.0	13.6	1.1	1.88	2.08	2.81	3.12	16.1
Rockwell Collins COL (9)	10081.1	60	30	20.8 b	39.6	836	22	2.6	17.3	1.6	1.06	2.20	2.73 *	3.19	13.9
United Technologies UTX	64765.6	65	15	14.6	19.0	342	18	1.4	14.0	1.6	1.64	3.12	3.69	4.14	10.9
(B) BUILDING PRODUCTS															
INDUSTRY COMPOSITE	3780.4	33	-6	22.7	22.6	315	15	0.6	9.4	1.2	0.80	-2.41	2.89	2.71	11.4
American Standard ASD	8913.9	45	12	17.3	51.0	926	19	0.8	13.0	1.3	1.61	2.56	2.67	3.05	13.0
Builders FirstSource BLDR	572.5	17	-22	82.4	33.9	230	7	0.2	5.4	0.7	0.00	1.55	2.25	1.91	11.3
Goodman Global GGL	1103.1	16	NA	-54.0	9.0	218	23	0.6	12.5	1.1	0.00	0.05	1.08	1.32	13.0
Griffon GFF (9)	710.5	24	0	14.2 b	12.6	172	14	0.4	8.2	1.4	0.00	1.55	1.65 *	2.04	10.0
Lennox International LII	1983.1	29	4	NM	19.8	241	13	0.5	9.7	NA	1.50	2.13	2.12	2.28	NA
Masco MAS	11073.5	29	-5	55.2	16.8	236	15	0.9	NA	1.2	3.07	2.03	2.21	2.01	11.0
Universal Forest Products UFPI	879.3	47	-16	21.3	15.2	174	12	0.3	7.6	1.3	0.24	3.53	3.60	4.13	10.0
USG USG	5007.3	56	-14	NM	NM	323	NM	0.9	NM	NA	0.00	-32.67	7.57	4.91	NA
(C) CONSTRUCTION & ENGINEERING															
INDUSTRY COMPOSITE	2897.5	52	29	-5.9	9.7	290	35	0.6	22.3	2.4	0.19	1.46	1.95	2.56	12.7
Emcor Group EME	1891.0	60	77	3.2	9.7	276	29	0.4	NA	2.8	0.00	1.93	2.16	2.82	10.0
Fluor FLR	7666.8	87	13	12.9	13.6	420	31	0.5	21.1	2.2	0.92	2.62	2.64	3.78	15.0
Granite Construction GVA	2159.3	52	44	13.0	16.4	313	19	0.7	11.9	1.8	0.78	2.02	2.38	2.85	12.3
Jacobs Engineering Group JEC (9)	4934.2	84	24	16.8 b	13.8	347	26	0.7	22.0	1.7	0.00	2.24	3.27 *	3.93	15.0
Perini PCR	860.3	33	35	-33.8	3.8	402	86	0.3	47.2	1.9	0.00	0.20	1.16	2.07	15.0
Quanta Services PWR	2172.6	18	39	-31.0	8.8	286	35	1.1	18.5	4.4	0.00	0.25	0.52	0.68	8.0
Shaw Group SGR (8)	2405.4	30	3	-25.4 b	4.3	193	45	0.5	27.9	3.0	0.00	0.25	0.66 *	1.48	15.0
URS URS	2291.2	44	17	-3.0	7.7	156	20	0.5	15.3	1.7	0.00	1.72	2.20	2.54	12.0
Washington Group International WGII	1696.6	59	11	NA	9.5	219	25	0.5	14.9	1.9	0.00	1.93	2.56	2.87	12.0
(D) ELECTRICAL EQUIPMENT															
INDUSTRY COMPOSITE	6315.3	52	37	16.2	17.4	347	22	1.5	15.6	1.6	1.16	1.99	2.81	3.24	13.0
Acuity Brands AYI (8)	2268.1	53	66	16.7 b	19.7	418	23	0.9	15.6	1.5	1.14	1.17	2.34 *	2.98	15.5
American Power Conversion APCC	5762.6	30	38	5.6	6.6	372	58	2.6	36.5	3.7	1.32	0.72	0.63	0.97	13.0
Ametek AME	3452.2	33	15	19.1	18.3	367	20	2.0	15.9	1.4	0.74	1.33	1.69	1.95	14.0



A a fourth-year music student studying at one of America's Historically Black Colleges and Universities (HBCU), Justin may one day lead the next great musical movement. A commitment to developing future leaders is why Honda created HBCU programs such as the Honda Campus All-Star Challenge and Honda Battle of the Bands. We believe the work done by America's Historically Black Colleges and Universities is truly worth a standing ovation.

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COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
Cooper Industries CBE	8312.8	91	25	10.6	19.6	354	19	1.7	14.5	1.4	1.62	4.12	5.09	5.78	12.5
Emerson Electric EMR (9)	34883.5	87	16	15.0 b	22.6	428	19	1.7	14.2	1.9	2.42	3.40	4.48 *	5.11	10.0
General Cable BGC	2186.2	43	116	-22.4	21.9	504	23	0.7	13.7	1.3	0.00	0.41	2.37	2.87	14.0
Hubbell HUB.B	3152.2	52	16	34.3	17.4	304	18	1.3	13.4	1.8	2.52	2.67	2.86	3.44	10.0
Regal-Beloit RBC	1580.1	51	44	24.7	14.6	215	16	1.0	11.1	1.3	1.10	2.25	3.27	3.62	12.0
Rockwell Automation ROK (9)	11115.7	65	10	30.9 b	32.7	579	19	2.0	14.5	1.4	1.78	2.77	3.49 *	3.87	13.0
Roper Industries ROP	4473.9	51	30	17.6	13.2	315	25	2.7	20.7	1.6	0.51	1.74	2.14	2.53	15.0
Smith (A.O.) AOS	1097.3	36	2	26.1	10.9	164	15	0.5	8.4	1.3	1.90	1.54	2.36	2.88	12.0
Superior Essex SPSX	722.3	35	76	NM	15.0	206	12	0.3	9.0	1.2	0.00	1.88	3.05	2.91	10.0
Thomas & Betts TNB	3092.0	52	24	NM	13.7	282	21	1.7	15.8	1.0	0.00	1.86	2.75	3.20	18.0
(E) INDUSTRIAL CONGLOMERATES															
INDUSTRY COMPOSITE	72464.6	58	16	2.3	28.5	614	22	1.6	13.1	1.4	1.44	2.36	3.57	4.00	12.0
General Electric GE	363669.8	35	1	NA	17.7	326	19	2.3	12.8	1.8	2.83	1.72	1.98	2.24	10.0
McDermott International MDR	5758.2	52	75	NM	92.5	2373	26	1.8	20.6	1.3	0.00	1.81	2.76	3.18	14.0
Teleflex TFX	2521.5	65	-1	4.2	12.2	216	18	1.0	NA	1.9	1.76	3.41	3.72	4.31	9.0
Textron TXT	12224.6	97	27	2.0	22.3	403	19	1.1	12.8	1.5	1.59	3.78	5.35	6.29	12.0
3M MMM	59984.4	81	5	23.5	31.6	546	18	2.7	13.5	1.6	2.26	4.16	4.54	5.00	11.0
Tyco International TYC (9)	60993.7	30	5	NA	11.5	172	15	1.5	9.9	1.2	1.32	1.45	1.97 *	2.03	13.0
Walter Industries WLT	2100.1	48	-3	-20.5	11.4	262	35	0.6	9.2	0.7	0.33	0.20	4.67	4.95	15.0
(F) MACHINERY															
INDUSTRY COMPOSITE	8248.7	54	26	30.5	18.9	308	18	1.2	12.4	1.4	1.23	2.65	3.67	3.83	13.3
AGCO AG	2842.7	31	88	1.5	0.0	182	NM	0.5	25.7	3.0	0.00	0.35	1.03	1.45	10.0
Briggs & Stratton BGG (6)	1341.2	27	-30	13.8 b	8.7	147	18	0.6	8.6	1.5	3.25	2.25	1.98 *	1.53	9.0
Caterpillar CAT	40352.7	62	7	36.6	38.8	447	12	1.0	7.9	0.8	1.93	4.04	5.20	5.61	15.6
Crane CR	2323.5	38	8	11.2	18.3	260	14	1.1	10.8	1.4	1.57	2.25	2.68	2.96	10.0
Cummins CMI	6068.0	120	34	NM	25.9	227	9	0.5	6.1	0.6	1.20	11.01	13.86	10.24	13.6
Danaher DHR	22506.3	73	31	28.9	17.1	366	22	2.4	18.0	1.5	0.11	2.76	3.23	3.71	15.0
Deere DE (10)	22194.9	96	41	NA	19.4	296	16	1.0	10.7	1.6	1.83	5.74	6.16 *	6.43	10.0
Donaldson DCI (7)	2819.7	35	10	13.0 b	23.3	483	22	1.6	15.6	1.9	1.03	1.27	1.55 *	1.76	12.0
Dover DOV	10269.4	50	24	30.5	15.1	271	18	1.6	NA	1.2	1.47	2.32	2.90	3.40	14.0
Eaton ETN	11484.9	77	15	44.5	20.1	262	13	0.9	NA	1.2	2.02	5.23	6.28	6.33	10.0
Flowserve FLS	3029.0	54	36	NM	9.9	319	33	1.0	19.8	3.8	0.00	0.82	2.03	3.28	7.0
Harsco HSC	3278.4	78	16	19.0	17.0	284	17	1.0	7.6	1.2	1.82	3.73	4.51	5.06	14.0
Illinois Tool Works ITW	26756.6	47	7	18.7	19.3	307	16	2.0	12.9	1.2	1.78	2.60	3.02	3.36	13.0
Ingersoll-Rand IR	11960.7	39	-3	61.9	19.6	211	12	1.1	9.1	1.0	1.74	3.09	3.30	3.54	12.0
ITT ITT	9965.4	54	5	13.1	9.2	316	35	1.3	NA	1.5	0.82	1.67	2.91	3.37	12.5
JLG Industries JLG (7)	2979.5	28	22	72.0 b	22.5	415	18	1.3	15.6	0.7	0.07	0.60	1.40 *	1.74	29.0
Joy Global JOYG (10)	5209.8	44	10	NM	44.1	595	14	2.3	NA	1.3	1.37	1.19	2.41	2.95	14.0
Kennametal KMT (6)	2357.6	61	20	50.5 b	20.7	179	9	1.0	6.8	0.5	1.38	2.99	6.88 *	4.38	16.8
Lincoln Electric Holdings LECO	2594.9	61	53	10.3	19.5	331	17	1.4	12.9	0.9	1.25	2.90	3.90	4.51	17.9
Manitowoc MTW	3710.4	60	140	4.5	18.8	533	29	1.4	NA	1.5	0.23	0.96	2.76	3.85	15.0
Oshkosh Truck OSK (9)	3534.5	48	8	33.8 b	19.4	333	17	1.0	14.5	0.8	0.83	2.18	2.76 *	3.26	22.5
Paccar PCAR	16214.0	65	41	60.0	30.3	344	12	1.0	8.8	0.9	1.23	4.37	5.95	4.25	11.8
Pall PLL (7)	3834.5	31	17	18.4 b	12.0	318	27	1.8	15.9	2.4	1.40	1.12	1.16 *	1.53	11.5
Parker Hannifin PH (6)	9844.0	83	27	47.4 b	16.5	231	14	1.0	9.9	1.4	1.25	4.43	5.28 *	6.41	11.5
Pentair PNR	3187.7	32	-8	55.2	11.2	194	18	1.0	12.3	1.3	1.76	1.80	1.74	2.06	14.0
SPX SPW	3506.8	61	34	NM	6.3	184	30	0.8	17.9	1.8	1.64	-0.28	3.06	3.57	11.0
Terex TEX	5624.4	56	89	NM	20.8	353	17	0.8	NA	1.6	0.00	1.85	4.00	4.96	8.5
Timken TKR	2799.5	30	-7	NM	16.6	165	10	0.5	5.7	0.9	2.15	2.81	2.70	2.99	12.0
Toro TTC (10)	1857.7	45	3	26.1 b	32.9	474	15	1.0	10.8	1.2	1.07	2.45	2.91 *	3.26	13.0
Trinity Industries TRN	3012.7	38	29	NM	13.3	219	16	1.0	NA	1.3	0.63	1.13	2.51	3.11	12.0
(G) TRADING COMPANIES & DISTRIBUTORS															
INDUSTRY COMPOSITE	2553.6	39	11	32.1	19.1	299	16	0.9	12.1	1.2	1.37	1.97	2.44	2.76	14.2
Applied Industrial Technologies AIT (6)	1242.3	28	27	46.6 b	18.2	295	17	0.6	13.8	1.1	1.69	1.20	1.57 *	1.87	16.0
BlueLinx Holdings BXC	333.7	11	-4	NA	18.4	169	9	0.1	5.9	1.3	4.63	1.46	0.83	0.98	10.0
Fastenal FAST	5432.8	36	-8	4.6	22.1	623	28	3.1	24.4	1.4	1.11	1.10	1.33	1.59	20.0
Grainger (W.W.) GWW	6225.6	72	2	19.7	17.1	273	17	1.1	12.8	1.3	1.60	3.78	4.07	4.69	13.3
Rush Enterprises RUSHA	456.4	18	22	43.7	17.2	141	8	0.2	6.8	0.8	0.00	1.79	2.31	1.70	9.4
United Rentals URI	2019.1	25	7	NM	14.7	135	12	0.5	3.1	1.5	0.00	1.80	2.27	2.72	7.5
Watsco WSO	1437.9	52	-14	29.4	16.7	282	17	0.8	15.8	0.9	1.93	2.52	3.09	3.57	18.6
WESCO International WCC	3281.0	67	57	48.7	28.6	472	17	0.6	14.6	0.9	0.00	2.10	4.07	4.95	19.0
17 COMMERCIAL SERVICES & SUPPLIES															
INDUSTRY GROUP COMPOSITE	**4125.7**	**37**	**15**	**10.5**	**18.3**	**389**	**24**	**1.0**	**12.7**	**1.7**	**1.20**	**1.62**	**1.86**	**2.14**	**12.7**
ABM Industries ABM (10)	1016.3	21	6	14.5	8.2	207	26	0.4	16.7	2.4	2.12	0.86	0.87	1.06	10.0
ACCO Brands ABD	1360.9	25	4	NA	8.0	316	40	0.7	15.9	2.2	0.00	1.32	1.07	1.51	11.0
Allied Waste Industries AW	4649.8	13	45	NM	4.7	155	26	0.8	5.9	1.8	0.00	0.43	0.53	0.63	13.5
Aramark RMK (9)	6004.8	33	20	3.1 b	17.2	395	24	0.5	10.0	2.0	0.84	1.53	1.41 *	1.76	12.0

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COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANALYSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
INDUSTRY COMPOSITE	41012.4	23	7	36.6	14.1	341	24	3.4	18.0	1.7	0.41	1.04	0.90	1.31	14.1
Andrew ANDW (9)	1569.5	10	-7	NM	-2.3	104	NM	0.7	34.9	NM	0.00	0.24	-0.22 *	0.56	11.0
Avaya AV (9)	5773.3	13	20	NM	9.6	277	30	1.1	5.3	3.0	0.00	1.89	0.43 *	0.64	10.0
Cisco Systems CSCO (7)	163128.4	27	57	37.4 b	23.2	639	28	5.4	22.3	2.0	0.00	0.87	0.89 *	1.29	15.0
Corning GLW	33547.4	22	10	NM	16.4	467	29	6.7	19.3	1.0	0.00	0.38	1.09	1.25	20.0
Harris HRS (6)	5604.1	42	-2	26.9 b	15.6	322	22	1.5	15.9	1.6	1.04	1.46	1.71 *	2.76	15.5
Motorola MOT	53596.0	22	-2	NM	23.0	313	14	1.3	11.9	1.5	0.90	1.82	1.33	1.54	10.9
Qualcomm QCOM (9)	60446.7	37	-15	45.6 b	18.4	451	25	8.0	22.1	1.3	1.31	1.26	1.44 *	1.81	20.0
Tellabs TLAB	4434.2	10	-8	NM	8.8	152	18	2.1	12.2	1.8	0.00	0.39	0.55	0.61	10.0
(B) COMPUTERS & PERIPHERALS															
INDUSTRY COMPOSITE	33154.7	38	14	54.8	20.2	491	26	1.9	34.9	1.9	0.36	1.62	1.82	2.08	13.4
Apple Computer AAPL (9)	78184.9	92	28	124.1 b	19.9	779	40	4.0	NA	2.0	0.00	1.56	2.27 *	2.73	20.0
Dell DELL (1)	62107.2	27	-9	33.5	94.5	1987	21	1.1	18.8	1.8	0.00	1.46	1.17	1.36	13.2
Diebold DBD	3013.5	46	21	6.2	6.5	279	45	1.0	18.9	1.7	1.87	1.17	1.79	2.42	15.0
EMC EMC	28873.5	13	-4	NM	9.0	263	31	2.7	16.9	1.7	0.00	0.47	0.52	0.62	15.0
Gateway GTW	706.6	2	-24	NM	-8.9	276	NM	0.2	142.7	6.2	0.00	0.02	0.04	0.11	8.8
Hewlett-Packard HPQ (10)	107962.6	39	38	NM	16.2	283	18	1.2	12.6	1.5	0.81	0.82	2.18 *	2.55	12.0
International Business Machines IBM	138463.9	92	12	5.7	26.8	404	16	1.5	10.5	1.5	1.31	4.91	5.98	6.54	10.0
Lexmark International LXK	6773.8	69	54	9.2	32.7	671	22	1.3	13.5	1.9	0.00	2.91	3.98	3.89	9.0
NCR NCR	7629.4	43	26	26.0	15.0	319	22	1.3	14.3	2.2	0.00	2.80	1.97	2.44	10.0
Network Appliance NTAP (4)	14600.2	39	45	188.2	14.1	744	55	6.1	39.3	1.4	0.00	0.69	1.11	1.37	25.0
Palm PALM (5)	1453.3	14	-12	NM	33.1	144	4	0.9	4.2	2.0	0.00	3.19	0.72	0.83	10.0
SanDisk SNDK	8733.1	44	-29	NM	11.1	264	24	3.1	18.3	0.9	0.00	2.00	2.40	2.76	20.0
Seagate Technology STX (6)	14760.5	26	29	45.2 b	11.5	288	24	1.5	11.7	1.3	1.40	1.41	1.60 *	1.65	12.0
Sun Microsystems SUNW (6)	19517.4	5	29	NM	-12.4	305	NM	1.4	158.7	NM	0.00	-0.03	-0.25 *	0.05	10.0
Western Digital WDC (6)	4541.1	21	10	NM	33.7	357	11	1.0	7.6	1.1	0.00	0.91	1.77 *	1.86	11.0
(C) ELECTRONIC EQUIPMENT & INSTRUMENTS															
INDUSTRY COMPOSITE	3219.3	32	13	29.4	13.9	247	18	0.9	13.3	1.3	0.13	1.17	1.88	2.08	14.7
Agilent Technologies A (10)	12990.7	32	-4	NA	39.5	356	10	2.6	8.0	0.6	0.00	0.38	3.27 *	1.82	15.0
Agilysys AGYS (3)	469.0	15	-16	NM	8.5	118	14	0.3	12.8	1.3	0.78	0.91	1.17	1.29	10.5
Amphenol APH	5952.5	68	54	23.5	27.0	689	27	2.6	19.7	1.3	0.18	2.28	2.89	3.49	18.0
Anixter International AXE	2302.1	59	50	29.1	19.5	254	14	0.5	11.5	0.9	0.00	2.22	4.23	4.71	15.0
Arrow Electronics ARW	3879.8	32	-1	NM	12.0	139	12	0.3	10.2	0.9	0.00	2.09	2.89	3.12	12.8
Avnet AVT (6)	3635.8	25	4	NM	8.4	125	15	0.2	11.8	1.0	0.00	1.39	1.39 *	2.38	17.5
Benchmark Electronics BHE	1570.1	24	8	NM	11.3	165	15	0.6	11.7	0.9	0.00	1.25	1.69	1.85	16.3
Brightpoint CELL	698.1	14	-10	95.1	21.5	395	18	0.3	13.9	1.0	0.00	0.64	0.71	0.94	19.5
CDW CDWC	5517.4	71	22	14.6	21.7	422	20	0.8	17.9	1.5	0.74	3.26	3.54	3.97	13.0
Ingram Micro IM	3375.6	20	2	116.6	9.5	124	13	0.1	10.5	1.3	0.00	1.32	1.56	1.71	9.8
Insight Enterprises NSIT	971.4	20	2	9.4	8.8	147	17	0.3	12.6	1.0	0.00	1.13	1.38	1.64	15.0
Mettler-Toledo International MTD	3042.1	77	40	10.7	23.9	486	22	2.0	17.3	1.6	0.00	2.52	3.50	4.05	14.0
Molex MOLX (6)	5891.8	32	23	34.1 b	11.3	250	23	1.9	12.1	1.7	0.94	0.81	1.26 *	1.71	15.0
Plexus PLXS (9)	1116.1	24	6	NM	20.9	232	11	0.8	NA	0.6	0.00	-0.29	2.16 *	1.52	17.8
ScanSource SCSC (6)	784.9	31	12	18.7 b	14.6	270	19	0.4	17.1	1.1	0.00	1.37	1.53 *	1.71	17.8
Solectron SLR (8)	3016.3	3	-9	NM	4.9	125	26	0.3	10.3	1.7	0.00	-0.01	0.13 *	0.22	15.0
Symbol Technologies SBL	3771.1	15	16	NM	7.9	286	36	2.1	21.9	1.9	0.00	0.13	0.45	0.59	17.1
SYNNEX SNX (11)	685.7	23	50	5.4	9.9	141	15	0.1	12.0	1.2	0.00	1.27	1.59	1.76	12.4
Tech Data TECD (1)	2298.5	42	6	-33.4	-6.7	141	NM	0.1	NM	3.7	0.00	0.39	1.22	2.05	9.1
Vishay Intertechnology VSH	2416.4	13	-5	NM	4.6	80	18	1.0	7.2	0.9	0.00	0.34	1.03	1.04	13.8
(D) OFFICE ELECTRONICS															
INDUSTRY COMPOSITE	15927.1	17	13		15.5	200	13	1.0	8.3	1.4	0.00	0.90	1.04	1.15	11.0
Xerox XRX	15927.1	17	13	NM	15.5	200	13	1.0	8.3	1.4	0.00	0.90	1.04	1.15	11.0
MATERIALS															
SECTOR COMPOSITE	6779.9	43	26	27.2	15.7	332	20	1.1	20.6	6.5	1.60	2.37	3.10	3.30	9.1
22 MATERIALS															
INDUSTRY GROUP COMPOSITE	**6779.9**	**43**	**26**	**27.2**	**15.7**	**332**	**20**	**1.1**	**20.6**	**6.5**	**1.60**	**2.37**	**3.10**	**3.30**	**9.1**
(A) CHEMICALS															
INDUSTRY COMPOSITE	7260.7	39	18	13.2	16.0	347	21	1.1	32.0	2.0	1.55	2.36	2.44	2.69	9.4
Air Products & Chemicals APD (9)	15302.8	69	17	NA	15.2	311	21	1.7	NA	2.1	1.97	3.06	3.29 *	3.96	10.0
Airgas ARG (3)	3313.1	43	29	21.6	14.2	320	23	1.1	11.7	1.7	0.66	1.62	1.97	2.34	12.4
Albemarle ALB	3301.9	70	82	13.2	10.9	321	30	1.4	14.4	1.7	1.03	2.41	3.76	4.30	11.0
Ashland ASH (9)	4807.3	68	17	60.6 b	5.9	155	27	0.7	16.4	NA	1.63	26.23	2.53 *	3.45	NA
Cabot CBT(9)	2615.0	41	15	-3.6 b	7.2	222	32	1.0	NA	2.1	1.75	-0.84	1.28 *	2.03	15.0
Celanese CE	3489.8	22	15	NA	90.1	639	8	0.5	4.5	1.1	0.73	1.61	2.78	2.82	7.5
CF Industries Holdings CF	1254.9	23	49	NM	2.0	161	81	0.7	11.8	6.3	0.35	-0.66	0.72	1.10	5.0
Chemtura CEM	2329.7	10	-24	NM	-9.0	127	NM	0.6	63.3	2.2	2.07	-1.04	0.48	0.64	9.0
Cytec Industries CYT	2531.1	53	12	-5.2	9.1	176	19	0.8	8.8	2.2	0.75	1.25	3.44	3.91	7.0
Dow Chemical DOW	38217.2	40	-9	NM	23.0	228	10	0.8	6.5	1.2	3.75	4.64	4.24	4.09	8.0

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COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANALYSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
DuPont DD	43153.4	47	10	-16.0	23.9	437	19	1.5	11.3	1.8	3.15	2.07	2.88	3.19	9.0
Eastman Chemical EMN	4879.7	59	15	NM	20.0	257	13	0.7	7.2	1.7	2.96	6.81	4.91	4.53	7.0
Ecolab ECL	11138.6	44	22	16.0	20.0	632	33	2.3	19.1	2.1	0.90	1.23	1.43	1.63	14.5
FMC FMC	2719.5	71	33	NM	15.4	266	18	1.2	9.4	1.6	1.02	2.83	5.44	6.31	8.0
Fuller (H.B.) FUL (11)	1554.6	26	63	7.3	12.2	229	19	1.0	11.6	2.0	0.96	1.06	1.48	1.62	9.0
Georgia Gulf GGC	697.0	20	-33	NM	24.9	151	6	0.3	3.9	2.0	1.57	2.79	3.15	2.48	3.3
Hercules HPC	2116.4	19	65	NM	NM	2749	NM	1.0	431.9	NA	0.00	-0.36	1.17	1.36	NA
Huntsman HUN	3841.3	17	1	NM	16.5	236	13	0.3	NA	NA	0.00	-0.03	1.59	1.78	NA
International Flavors & Fragrances IFF	4220.3	47	41	14.2	20.2	440	22	2.1	14.9	1.9	1.78	2.04	2.44	2.68	10.0
Lubrizol LZ	3250.1	47	9	NA	11.5	194	17	0.8	9.1	1.6	2.20	2.63	3.08	3.40	9.8
Lyondell Chemical LYO	6137.5	25	4	NM	18.7	177	10	0.3	4.7	1.8	3.64	2.04	3.34	3.57	4.2
Monsanto MON (8)	26110.5	48	24	45.9 b	10.7	400	38	3.6	21.5	2.0	0.83	0.29	1.27 *	1.59	19.0
Mosaic MOS (5)	9317.6	21	46	NM	-2.7	256	NM	1.8	39.4	3.7	0.00	-0.35	0.82	1.33	7.0
Nalco Holding NLC	2850.8	20	13	NA	10.5	349	34	0.8	9.8	1.7	0.00	0.33	0.79	1.03	15.0
Olin OLN	1219.6	17	-15	NM	29.8	224	8	0.4	5.2	1.7	4.78	1.95	1.61	1.54	6.0
PolyOne POL	711.6	8	19	NM	25.5	138	5	0.3	3.8	NA	0.00	0.68	0.92	0.67	NA
PPG Industries PPG	10626.3	64	11	11.1	19.2	305	16	1.0	10.2	1.5	2.99	3.49	5.22	5.20	8.5
Praxair PX	20148.9	62	18	13.9	20.9	448	22	2.5	12.3	1.8	1.60	2.22	2.95	3.37	11.9
Rockwood Holdings ROC	1867.5	25	28	NM	7.8	180	24	0.6	6.3	2.1	0.00	1.52	1.43	1.77	8.5
Rohm and Haas ROH	11397.4	52	8	NM	17.7	281	16	1.4	9.7	1.5	2.53	2.86	3.43	3.57	10.0
RPM International RPM (5)	2397.2	20	16	NM	-6.7	246	NM	0.8	201.6	NA	3.47	-0.65	1.51	1.68	NA
Schulman (A.) SHLM (8)	622.8	23	6	-0.2 b	8.1	155	21	0.4	10.8	NA	2.55	1.03	1.07 *	1.23	NA
Scotts Miracle-Gro SMG (9)	3250.2	49	9	5.4 b	12.5	300	25	1.2	NA	2.0	1.01	1.47	1.96 *	2.88	12.5
Sigma-Aldrich SIAL	5015.6	76	20	16.7	19.5	372	20	2.9	14.2	1.9	1.10	3.76	4.00	4.30	10.0
Valspar VAL (10)	2842.7	28	13	10.0 b	14.0	230	16	1.0	11.6	1.6	1.57	1.42	1.71 *	1.85	10.0
Westlake Chemical WLK	2136.6	33	14	NM	21.6	182	8	0.8	6.5	1.9	0.49	3.48	3.74	3.67	4.7
(B) CONSTRUCTION MATERIALS															
INDUSTRY COMPOSITE	6423.1	94	30	13.9	21.0	396	20	2.3	12.4	1.5	1.39	3.72	4.92	5.94	16.3
Martin Marietta Materials MLM	4469.0	99	29	17.9	18.2	354	20	2.1	NA	0.8	1.11	4.14	5.22	6.41	23.5
Vulcan Materials VMC	8377.3	89	31	9.9	23.8	438	20	2.6	12.4	2.1	1.67	3.30	4.63	5.47	9.0
(C) CONTAINERS & PACKAGING															
INDUSTRY COMPOSITE	3189.7	37	18	6.3	7.0	341	20	0.8	9.6	2.0	1.37	0.83	2.10	2.30	9.9
Ball BLL	4448.9	43	8	NM	28.9	397	14	0.7	7.9	1.1	0.94	2.38	2.79	3.27	14.5
Bemis BMS	3578.1	34	22	3.4	12.0	240	20	1.0	10.8	1.5	2.23	1.51	1.88	2.07	12.0
Crown Holdings CCK	3356.2	21	5	NM	NM	NM	NM	0.5	NM	1.6	0.00	-2.12	1.17	1.41	11.0
Greif GEF (10)	2291.5	99	50	NA	16.8	271	16	0.9	10.8	1.0	1.45	4.49	6.08 *	5.03	17.0
Owens-Illinois OI	2904.6	19	-10	NM	-92.9	662	NM	0.4	NM	3.3	0.00	-4.26	0.81	1.26	7.0
Packaging Corp. of America PKG	2355.6	23	-2	-15.9	12.4	337	27	1.1	9.7	NA	4.43	0.49	1.16	1.50	NA
Pactiv PTV	4585.8	34	57	0.8	34.3	589	18	1.6	11.1	2.0	0.00	0.96	1.61	1.81	10.5
Rock-Tenn RKT (9)	926.3	25	85	-3.0 b	5.6	182	33	0.4	7.0	4.1	1.43	0.49	0.77 *	1.52	8.0
Sealed Air SEE	4800.5	60	6	21.9	17.0	310	21	1.1	11.1	1.7	1.01	2.69	3.00	3.36	11.5
Silgan Holdings SLGN	1614.2	43	19	19.0	28.4	471	17	0.6	7.3	1.8	1.11	2.33	2.68	3.01	9.0
Smurfit-Stone Container SSCC	2739.1	11	-24	NM	-11.0	161	NM	0.4	13.4	NM	0.00	-1.33	-0.15	0.48	5.0
Sonoco Products SON	3682.4	37	26	17.3	14.5	275	19	1.0	10.3	2.4	2.60	1.61	2.12	2.31	7.3
Temple-Inland TIN	4183.1	39	-13	7.1	17.8	191	11	0.8	6.5	1.9	2.56	1.54	3.36	2.91	6.0
(D) METALS & MINING															
INDUSTRY COMPOSITE	7999.5	51	56	74.8	25.9	336	16	1.2	8.6	18.6	1.46	3.49	5.23	5.25	8.1
AK Steel Holding AKS	1817.6	16	107	NM	7.8	664	92	0.3	8.4	1.0	0.00	-0.01	0.85	1.39	20.0
Alcoa AA	27026.8	31	5	8.2	14.4	184	13	0.9	8.0	0.9	1.92	1.40	2.90	2.97	12.0
Aleris International ARS	1633.2	52	62	NM	12.0	361	31	0.4	12.3	NA	0.00	2.38	5.26	7.37	NA
Allegheny Technologies ATI	9024.8	90	148	NM	42.6	731	17	2.0	14.9	1.1	0.45	3.59	5.44	6.50	15.0
Carpenter Technology CRS (6)	2727.7	107	52	NM	22.3	280	13	1.7	10.1	NA	0.84	5.37	8.08 *	9.05	NA
Chaparral Steel CHAP (5)	2152.7	47	207	NM	27.0	293	11	1.4	8.7	NA	0.86	3.32	4.86	4.81	NA
Commercial Metals CMC (8)	3424.4	29	55	68.3 b	29.2	281	10	0.5	7.8	2.0	0.83	2.32	2.89 *	3.10	5.0
Freeport-McMoRan Copper & Gold FCX	12380.9	63	17	72.3	59.9	958	9	2.2	7.2	0.8	1.99	4.67	6.99	5.71	11.0
Metal Management MM (3)	965.0	37	58	33.4 a	24.7	214	9	0.5	7.1	1.4	0.82	2.35	3.72	3.47	7.0
Newmont Mining NEM	19817.6	47	-12	NM	7.7	219	30	4.1	15.1	293.0	0.85	0.83	1.60	1.97	0.1
Nucor NUE	18081.6	60	79	83.4	36.2	388	11	1.2	8.8	2.1	0.67	4.13	5.76	4.84	5.0
Phelps Dodge PD	25092.0	123	71	NM	29.0	387	13	2.3	10.8	0.9	0.65	7.82	16.40	15.97	7.9
Quanex NX (10)	1371.8	37	11	28.5 b	24.4	209	9	0.7	5.9	0.7	1.51	4.50	4.09 *	3.73	12.5
Reliance Steel & Aluminum RS	2904.5	38	26	48.4	20.3	174	8	0.6	7.3	1.9	0.62	3.11	5.06	5.05	4.0
Ryerson RYI	584.3	22	-8	NM	12.9	91	8	0.1	4.8	4.1	0.90	3.78	2.72	2.88	2.0
Schnitzer Steel Industries SCHN (8)	1258.2	41	34	112.0 b	19.5	171	9	0.7	7.3	1.8	0.17	4.72	4.65 *	4.22	5.0
Southern Copper PCU	16109.9	55	63	NM	52.8	472	9	3.2	7.8	0.8	10.05	4.76	6.91	7.94	9.6
Steel Dynamics STLD	3090.3	33	83	180.8	30.4	264	10	1.0	6.6	0.9	1.23	2.18	3.78	3.67	10.0
United States Steel X	8884.3	75	56	NM	28.0	212	8	0.6	5.5	1.1	1.07	7.00	11.04	8.72	6.0
Worthington Industries WOR (5)	1643.1	19	-4	112.8	16.5	169	10	0.6	7.5	2.3	3.68	1.64	1.61	1.71	5.0

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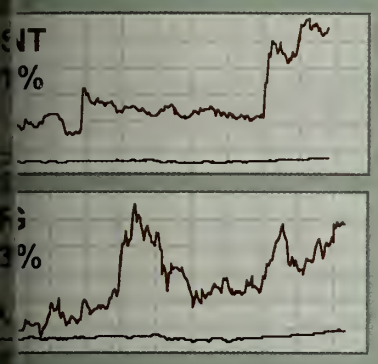
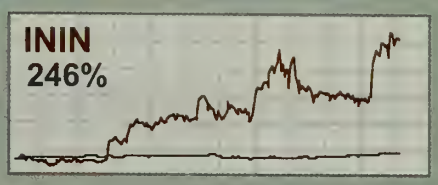
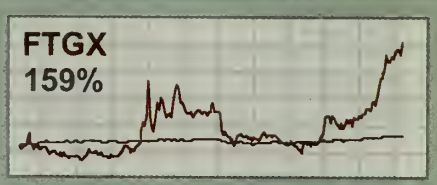
6 TOP COMPANIES: AVERAGE 183% RETURN

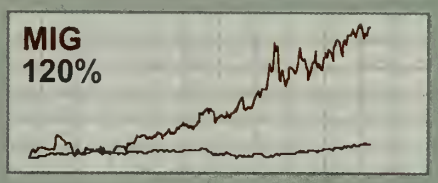
Equity Investor's Micro-Cap Review

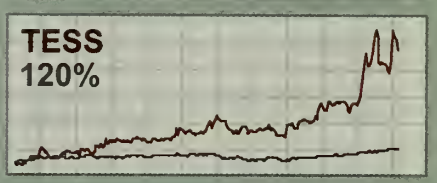
licro-Cap companies featured on this page were among America's top domestically traded companies arket capitalizations from $20 million to $500 million, in terms of 12-month share price performance for eriod ending 10/31/06. While past performance is never a guarantee of future results, these six companies ent investment opportunities worthy of any Micro-Cap investor's close consideration.











2 Month Price Performance for period ending 10/31/06 ● Stock ● S&P500

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bol: **VSNT** (Nasdaq)
stry: Object-Oriented Database S/W
ontact: Jerry Wong
g@versant.com

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- RKET CAPITALIZATION: $44 mil
- RRENT RATIO: 2.09
- BT TO EQUITY RATIO: .47
- TURN ON SALES RATIO: .26
- OSS PROFIT MARGIN RATIO: .82

Interactive Intelligence, Inc.

Symbol: ININ (Nasdaq)
Industry: Communications Software
IR Contact: Stephen R. Head
steve.head@ININ.com

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- MARKET CAPITALIZATION: $309.7 mil
- '06 9 MONTH REVENUE INCREASE: 31%
- '06 9 MONTH OP. INCOME IMP.: 548%
- '06 9 MONTH OP. CASH FL. IMP: $6.6 mil
- DEBT: $0

FiberNet Telecom Group, Inc.

Symbol: FTGX (Nasdaq)
Industry: Telecommunications
IR Contact: Norma Salcido
investor.relations@ftgx.com

FIBERNET

FiberNet provides interconnection services enabling the exchange of voice, video, data and VoIP traffic between global networks and Internet hubs. The Company owns and operates next-generation networks and data centers in gateway markets providing recurring connectivity and colocation services for 242 domestic and international customers.

- MARKET CAPITALIZATION: $32.83 mil
- Q3:06 REVENUE GROWTH: 20% over pr. yr.
- Q3:06 EBITDA MARGIN: 14.5%
- Q3:06 Ops Cash Fl. – Cap.Exp.: $866,000
- BOOK VALUE PER SHARE: $6.23

nteer Group

ol: FRG (AMEX)
stry: Mining and Exploration
ntact: Jessica Delaney
fronteergroup.com

Fronteer
The Science of Discovery

oner is an ced discovery- exploration any focused on us and strategic metals. Fronteer has le gold projects in northwestern Turkey, o, and Canada's Yukon territory, as well 7% interest in Aurora Energy (AXU-SX) a pure play Canadian uranium company.

- RKET CAPITALIZATION: 391.5 mil
- RE PRICE: $9.90 (AMEX 11/23/06)
- LORATION EXPENDITURES: $26 mil
- NIUM SPOT PRICE: $64
- D PRICE: $646

Meadowbrook Insurance Group, Inc.

Symbol: MIG (NYSE)
Industry: Property & Casualty Insurance
IR Contact: Holly A. Moltane
hmoltane@meadowbrook.com

MEADOWBROOK® INSURANCE GROUP

Meadowbrook is a risk management organization offering a full range of property/casualty insurance products and services, focused on niche business. Poised to obtain an upgrade from rating agency A.M. Best, Meadowbrook continues to add new business and execute select acquisitions.

- MARKET CAPITALIZATION: $307.1 mil
- REVENUE GROWTH: (3 year CAGR) 15.3%
- COMB. RATIO 9 MTHS END 9/30/06: 96.9%
- EPS GROWTH: (3 year CAGR) 26.6%
- SHAREHOLDERS EQ GR.: (3yr CAGR) 8.0%

TESSCO Technologies Inc.

Symbol: TESS (Nasdaq)
Industry: Wireless Communications
IR Contact: David Young; CFO
young@tessco.com

TESSCO

TESSCO is helping to build the world's wireless future – with the breadth and depth of essential products, services and training solutions needed to develop and maintain this complex, ever-evolving world. Offering industry-leading expertise for more than 25 years, TESSCO is wired into everything wireless.

- MARKET CAPITALIZATION: $117.1 mil
- Q2 FY07 CORE REV. GROWTH: 48%
- Q2 FY07 BUYER GROWTH: 14%
- Q2 FY07 RETURN ON EQUITY: 12%
- TTM EPS: $1.38

COMPANY TICKER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %
(E) PAPER & FOREST PRODUCTS															
INDUSTRY COMPOSITE	7915.9	34	-10	-2.1	-8.9	164	28	0.7	22.4	3.2	3.27	1.39	1.22	1.36	6.4
Bowater BOW	1250.5	22	-29	NM	-37.4	136	NM	0.4	NM	NM	3.67	-2.09	-1.05	-0.06	4.0
International Paper IP	15053.9	33	-2	NM	-17.7	256	NM	0.6	57.2	4.2	3.02	1.74	1.33	2.03	6.0
Louisiana-Pacific LPX	2217.6	21	-23	NM	11.4	105	9	0.9	5.9	2.3	2.84	4.34	1.29	0.09	7.0
MeadWestvaco MWV	5344.8	30	5	-13.7	3.2	151	48	0.8	9.6	3.8	3.12	0.62	0.96	1.41	8.0
Weyerhaeuser WY	15712.6	65	-3	9.5	-3.8	170	NM	0.7	17.0	2.6	3.71	2.36	3.57	3.34	7.0
TELECOMMUNICATION SERVICES SECTOR COMPOSITE	34425.0	31	29	22.6	15.7	477	25	2.1	8.5	3.6	2.40	1.14	1.47	1.72	10.0
23 TELECOMMUNICATION SERVICES															
INDUSTRY GROUP COMPOSITE	**34425.0**	**31**	**29**	**22.6**	**15.7**	**477**	**25**	**2.1**	**8.5**	**3.6**	**2.40**	**1.14**	**1.47**	**1.72**	**10.0**
(A) DIVERSIFIED TELECOMMUNICATION SERVICES															
INDUSTRY COMPOSITE	35940.5	26	37	27.0	18.2	467	16	1.8	6.8	4.3	2.99	0.85	1.34	1.57	6.9
AT&T T	130312.8	34	38	-8.5	12.8	235	18	2.2	7.8	1.5	3.92	1.42	2.31	2.57	10.0
BellSouth BLS	81243.0	45	65	1.8	13.2	319	24	3.9	11.7	2.5	2.60	1.59	2.38	2.58	7.4
CenturyTel CTL	4910.3	43	28	24.1	11.4	149	14	2.0	5.4	4.9	0.59	2.49	2.48	2.68	3.5
Citizens Communications CZN	4556.6	14	16	NM	27.1	463	17	2.2	6.0	4.5	7.06	0.59	0.65	0.69	4.9
EMBARQ EQ	7686.6	51	NA	NA	NM	NM	10	1.2	4.4	3.5	3.89	NA	4.83	4.46	3.0
IDT IDT (7)	1057.5	13	11	NM	-20.7	129	NM	0.5	NM	NM	0.00	-0.58	-2.32 *	-0.68	NA
Level 3 Communications LVLT	6274.3	5	86	NM	NM	1116	NM	1.8	NM	NM	0.00	-0.98	-0.70	-0.47	22.5
Qwest Communications International Q	14715.5	8	36	NM	NM	NM	NM	1.1	6.3	4.6	0.00	-0.41	0.28	0.40	6.0
Verizon Communications VZ	102007.8	35	16	90.8	14.0	220	16	1.2	4.9	4.6	4.64	2.65	2.54	2.47	3.0
Windstream WIN	6641.0	14	NA	NA	69.7	1102	14	2.3	7.8	8.1	7.17	NA	0.92	0.97	1.9
(B) WIRELESS TELECOMMUNICATION SERVICES															
INDUSTRY COMPOSITE	29373.2	47	7	5.1	9.9	395	45	2.8	13.2	1.8	0.46	1.91	1.93	2.25	19.3
Alltel AT	21497.6	57	-10	5.1	6.3	161	26	2.6	9.9	2.8	0.88	3.80	2.96	2.82	6.9
NII Holdings NIHD	10043.0	65	49	NM	21.6	918	47	4.5	24.3	1.0	0.00	1.06	1.55	2.61	41.5
Sprint Nextel S	56579.0	20	-16	NM	1.7	107	63	1.4	5.3	1.6	0.51	0.87	1.26	1.33	9.6
UTILITIES SECTOR COMPOSITE	8715.0	40	20	2.6	12.0	227	22	1.2	9.0	3.4	3.05	1.79	2.21	2.52	6.7
24 UTILITES															
INDUSTRY GROUP COMPOSITE	**8715.0**	**40**	**20**	**2.6**	**12.0**	**227**	**22**	**1.2**	**9.0**	**3.4**	**3.05**	**1.79**	**2.21**	**2.52**	**6.7**
(A) ELECTRIC UTILITIES															
INDUSTRY COMPOSITE	11726.8	40	20	0.1	8.4	203	31	1.4	9.4	3.4	3.01	1.72	2.19	2.52	7.3
Allegheny Energy AYE	7330.0	44	40	-40.7	12.8	366	29	2.4	13.5	1.1	0.00	0.47	1.81	2.26	21.5
American Electric Power AEP	16374.9	42	12	-3.1	9.5	172	18	1.3	7.1	3.8	3.76	2.63	2.75	2.89	4.0
Edison International EIX	14980.8	46	5	1.2 a	13.2	199	14	1.2	6.4	2.4	2.35	3.34	2.93	3.36	6.5
Entergy ETR	19046.4	91	33	8.5	11.0	223	20	1.7	8.9	2.4	2.37	4.40	4.67	5.64	8.0
Exelon EXC	40749.8	61	14	-11.1	2.1	420	209	2.6	24.4	2.1	2.63	1.40	3.28	4.49	9.0
FirstEnergy FE	19101.3	60	22	-1.5	12.9	207	16	1.6	6.9	3.1	3.01	2.65	3.82	4.13	5.0
FPL Group FPL	21573.0	53	28	-0.2	12.7	225	17	1.4	8.9	2.3	2.81	2.29	2.90	3.37	8.0
Great Plains Energy GXP	2538.1	32	13	NM	8.9	196	20	1.0	9.2	7.9	5.25	2.18	2.00	1.95	2.0
Hawaiian Electric Industries HE	2201.3	27	4	-0.3	10.2	178	17	0.9	NA	5.8	4.58	1.57	1.56	1.64	3.0
Northeast Utilities NU	4315.7	28	42	NM	3.3	175	51	0.6	13.1	2.1	2.68	-1.74	1.14	1.42	12.0
Pepco Holdings POM	4904.1	26	15	6.1	8.1	136	17	0.6	6.8	4.6	4.06	1.91	1.40	1.66	4.0
Pinnacle West Capital PNW	4926.5	49	19	-12.0	9.7	145	15	1.5	7.2	2.6	4.26	2.31	3.18	3.31	6.0
Portland General Electric POR	1736.9	28	NA	NA	1.8	145	NA	1.2	7.1	3.9	3.24	NA	1.01	1.72	7.0
PPL PPL	13885.7	36	24	34.9	16.7	273	16	2.1	8.6	1.5	3.03	1.92	2.25	2.33	10.5
Progress Energy PGN	12133.6	48	9	-4.6	5.3	151	28	1.2	8.1	4.7	5.07	2.94	2.53	2.76	4.0
Reliant Energy RRI	4139.1	13	30	NM	-12.2	112	NM	0.4	NM	NM	0.00	-1.46	-0.18	0.29	5.0
Sierra Pacific Resources SRP	3627.5	16	26	NM	10.5	140	12	1.1	7.2	1.5	0.00	0.44	0.74	0.86	15.0
Southern SO	26924.3	36	5	7.2	13.0	239	18	1.9	9.7	3.5	4.28	2.13	2.09	2.19	5.0
Westar Energy WR	2320.2	27	24	16.9	10.3	154	15	1.4	7.0	5.3	3.76	1.53	1.68	1.65	3.0
(B) GAS UTILITIES															
INDUSTRY COMPOSITE	2760.4	41	25	3.4	11.1	220	18	0.9	10.9	3.9	3.16	2.10	2.05	2.42	5.6
AGL Resources ATG	2960.2	38	10	11.2	14.6	187	13	1.0	8.1	3.5	3.85	2.48	2.64	2.69	4.
Atmos Energy ATO (9)	2672.0	33	25	5.8 b	9.0	162	18	0.4	8.0	3.0	3.91	1.72	1.82 *	1.96	6.0
Laclede Group LG (9)	780.3	37	25	18.2 b	12.0	192	16	0.4	9.8	NA	3.88	1.90	2.30 *	2.13	N/
National Fuel Gas NFG (9)	3161.0	38	22	3.4 b	9.6	219	24	1.4	9.9	4.7	3.17	1.81	1.61 *	2.33	5.0
New Jersey Resources NJR (9)	1429.6	52	24	7.6 b	12.6	230	18	0.4	12.6	3.7	2.94	2.71	2.80 *	2.89	5.0
Nicor GAS	2211.9	50	26	3.4	15.9	267	17	0.6	7.6	5.3	3.75	3.07	2.69	2.71	3.!
Oneok OKE	4763.8	43	62	NA	21.9	221	10	0.4	6.9	2.2	2.96	3.73	2.41	2.57	8.0
Peoples Energy PGL (9)	1667.3	43	24	NM	-3.3	198	NM	0.6	18.4	NM	5.02	1.75	-0.73 *	1.76	N/
Piedmont Natural Gas PNY (10)	2099.9	28	15	6.9	10.9	233	21	1.1	11.3	5.4	3.44	1.32	1.29	1.42	4.0
Questar STR	7405.9	86	14	17.8	20.0	347	18	2.5	10.2	1.9	1.09	3.74	4.77	5.75	9.
Southern Union SUG	3352.8	28	19	-52.7	-1.2	197	NM	1.4	24.4	2.3	1.43	0.03	1.50	1.82	8.0
Southwest Gas SWX	1554.4	38	42	-0.2	8.2	189	22	0.8	6.7	6.3	2.18	1.14	2.00	2.11	3.

KER (FY)	MARKET VALUE ($)	RECENT SHARE PRICE	2006 PRICE CHANGE %	EARNINGS GROWTH 2001-2005	RETURN ON EQUITY	PRICE AS % OF BOOK VALUE	P-E RATIO	PRICE-SALES RATIO	PRICE-CASH FLOW RATIO	P-E TO GROWTH RATE	YIELD %	EARNINGS PER SHARE 2005 ACTUAL	ESTIMATES FROM ANAYLSTS 2006 ANALYST EST.	2007 CON-SENSUS	LONG-TERM GROWTH RATE %	S&P EQUITY RANKING
)	2970.6	28	37	16.4 b	15.4	260	17	0.6	9.4	2.1	2.50	1.77	1.65 *	1.79	8.0	A
gs WGL (9)	1615.4	33	10	NA	9.8	176	17	0.6	8.6	5.8	4.08	2.16	1.90 *	1.90	3.0	B+
-UTILITIES																
COMPOSITE	8924.1	38	16	0.2	10.6	185	18	1.1	7.9	3.6	3.55	2.05	2.27	2.51	5.5	
gy LNT	4515.5	39	39	-25.2	3.2	182	54	1.3	11.9	3.4	2.96	0.48	2.31	2.48	5.0	B
E	11281.2	55	7	-2.4	7.8	172	21	1.6	9.3	4.9	4.64	3.13	2.80	3.88	4.0	A-
t Energy CNP	5106.5	16	27	-13.9	28.5	326	12	0.5	5.0	1.5	3.67	0.67	1.04	1.04	10.5	B
y CMS	3603.5	16	12	NM	-3.2	158	NM	0.5	7.5	4.0	0.00	-0.51	1.02	1.16	4.0	C
d Edison ED	12372.4	48	4	-2.2	8.4	156	18	1.0	9.5	5.6	4.77	2.99	2.85	3.14	3.0	B+
esources D	28582.0	81	5	8.7	11.7	211	18	1.6	9.0	1.9	3.42	3.00	5.10	5.87	8.5	B+
DTE	8380.4	47	9	12.2	11.6	143	12	0.9	5.0	4.2	4.37	3.27	2.49	2.88	4.5	B+
y DUK	39808.6	32	16	13.5	7.8	150	17	2.8	10.1	3.5	4.04	2.61	1.81	1.93	5.0	B+
EAS	3608.5	24	7	1.8	8.8	130	15	0.7	6.8	3.4	4.91	1.74	1.82	1.53	4.0	B+
SE	7189.8	41	15	-4.0 a	9.4	157	17	0.9	8.7	6.4	4.53	2.32	2.34	2.44	2.8	B
rces Group MDU	4760.7	26	21	10.8	14.5	226	15	1.2	8.3	2.3	2.05	1.53	1.63	1.78	7.0	A
I	6729.7	25	18	3.4	6.1	140	23	0.8	8.0	5.3	3.73	1.04	1.33	1.51	3.5	B
	3757.5	35	23	NM	12.6	237	18	1.0	6.7	2.6	3.70	1.83	1.95	2.12	7.0	A-
OGE	3574.5	39	46	11.4	14.4	231	16	0.7	8.8	2.8	3.47	1.83	2.31	2.24	6.2	A-
	15952.0	46	24	-5.0	12.7	206	16	1.2	5.9	2.3	2.87	2.28	2.52	2.72	8.0	B
rces PNM	2160.1	31	25	-20.4	6.8	156	23	0.9	8.7	1.5	2.87	1.01	1.75	2.04	12.0	B+
ce Enterprise Group PEG	16946.1	67	3	-1.2	11.0	243	22	1.3	10.5	4.6	3.39	3.51	3.67	4.70	4.0	B+
y PSD	2891.3	25	22	2.6	7.9	138	17	1.0	6.5	4.2	4.03	1.42	1.48	1.64	4.0	B
	4806.5	41	5	-14.1	10.6	170	15	1.0	7.3	3.4	4.07	2.81	2.73	2.84	4.5	B
rgy SRE	14279.0	55	22	10.0	17.3	191	11	1.1	7.2	3.5	2.20	3.69	3.66	3.68	4.3	B
TE	3552.6	17	-1	-14.6	14.7	210	14	1.0	6.7	5.8	4.47	1.00	0.98	1.08	3.0	B-
	2175.5	29	5	19.3	10.9	191	18	1.0	7.4	5.2	4.41	1.80	1.58	1.82	3.5	B+
nergy WEC	5472.3	47	20	12.3	11.4	193	17	1.4	8.3	2.3	1.97	2.56	2.57	2.61	8.0	B
rces WPS	2261.6	52	-5	NA	9.2	145	15	0.3	9.0	3.1	4.40	4.11	3.79	4.09	4.5	A-
XEL	9333.8	23	24	NA	9.8	164	17	0.9	6.8	3.1	3.88	1.20	1.34	1.43	5.5	B
ENDENT POWER PRODUCERS & ENERGY TRADERS																
COMPOSITE	12201.2	41	28	28.5	31.2	494	18	1.5	7.8	1.4	0.87	0.20	2.41	2.80	11.9	
	15504.2	23	48	12.2	14.7	580	40	1.3	NA	1.6	0.00	0.95	1.07	1.20	14.0	B-
n Energy Group CEG	12342.9	69	19	45.7	15.9	285	17	0.6	9.7	1.4	2.20	3.38	3.79	4.54	13.0	B
J	3381.4	7	40	NM	-29.4	146	NM	1.5	NM	NM	0.00	-2.13	-0.02	0.33	6.0	C
	7822.8	30	NA	NM	34.3	245	9	1.9	6.6	1.6	0.00	-4.28	1.28	1.66	15.0	NR
NRG	7799.8	57	21	NA	9.8	153	12	1.5	6.8	1.8	0.00	0.66	2.79	3.64	11.6	NR
	26355.8	57	14	27.7	142.1	1554	11	2.4	8.1	0.9	3.01	2.61	5.57	5.41	12.0	B

iabetical List of Companies

nber following each company name identifies the Scoreboard category under which it is listed

tories 15b
, Fitch 5d
s 17
17
16d
s 19c
Parts 5d
o 20
20
logies 21c
24b
Chemicals 22a
gs 18b
g 22d
p 18b
2
ldwin 18c
gy 24a
22d
ys. 19b
24c
tems 16a
ds. 17
gy 9b
esources 9b
Altria Group 7c
Amazon.com 5b
Ambac Financial 12
Ameren 24c
American Axle & Mfg. 1a
American Eagle Outfitters 5d
American Electric 24a
American Express 11b
American Financial 12
American Greetings 2a
American Intl. Group 12
American Power 16d
American Standard 16b
AmeriCredit 11b
Amerigroup 14b
Ameriprise Finl. 11a
AmerisourceBergen 14b
Ametek 16d
Amgen 15a
Amkor Technology 20
Amphenol 21c
AMR 18b
Anadarko Petroleum 9b
Analog Devices 20
Andrew 21a
Anheuser-Busch 7a
Anixter International 21c
AnnTaylor Stores 5d
Aon 12
Apache 9b
Apollo Group 3b
Apple Computer 21b
Applied Biosystems 15c
Applied Industrial Tech. 16g
Applied Materials 20
Apria Healthcare Group 14b
Aramark 17
Arch Coal 9b
Archer Daniels 7b
Arkansas Best 18d
Armor Holdings 16a
Arrow Electronics 21c
ArvinMeritor 1a
Asbury Automotive 5d
Ashland 22a
Assurant 12
AT&T 23a
Atlas Air Worldwide 18a
Atmos Energy 24b
Autoliv 1a
Automatic Data 19b
AutoNation 5d
AutoZone 5d
Avaya 21a
Avery Dennison 17
Avis Budget Group 18d
Avnet 21c
Avon Products 8b
B
Baker Hughes 9a
Ball 22c
Bank of America 11c
Bank of New York 11a
Banta 17
Bard (C.R.) 14a
Barnes & Noble 5d
Baxter International 14a
BB&T 10a
Bear Stearns 11a
Beazer Homes USA 2a
Beckman Coulter 14a
Becton, Dickinson 14a
Bed Bath & Beyond 5d
BellSouth 23a
Belo 4
Bemis 22c
Benchmark Electronics 21c
Berkley (W.R.) 12
Berkshire Hathaway 12
Best Buy 5d
Big Lots 5c
Biogen Idec 15a
Biomet 14a
BJ Services 9a
BJ's Wholesale Club 6
Black & Decker 2a
Block (H&R) 3b
Blockbuster 5d
BlueLinx Hldngs. 16g
BMC Software 19c
Bob Evans Farms 3a
Boeing 16a
Borders Group 5d
BorgWarner 1a
Boston Scientific 14a
Bowater 22e
Boyd Gaming 3a
Briggs & Stratton 16f
Brightpoint 21c
Brinker International 3a
Brink's 17
Bristol-Myers Squibb 15b
Brown Shoe 2c
Brown-Forman 7a
Brunswick 2b
Builders FirstSource 16b
Building Materials 5a
Bunge 7b
Burger King Hldgs. 3a
Burlington Northern Santa Fe 18d
C
CA 19c
Cabela's 5d
Cablevision Systems 4
Cabot 22a
CACI International 19b
Cameron Intl. 9a
Campbell Soup 7b
Capital One Financial 11b
Caroinal Health 14b
Career Education 3b
Caremark Rx 14b
CarMax 5d
Carnival 3a
Carolina Group 7c
Carpenter Tech. 22d
Casey's General Stores 6
Caterpillar 16f
CB Richard Ellis 13b
CBRL Group 3a
CBS 4
CDW 21c
Celanese 22a
Celgene 15a
Centene 14b
CenterPoint Energy 24c
Centex 2a
CenturyTel 23a
Ceridian 19b
CF Industries Hldgs. 22a
Chaparral Steel 22d
Charming Shoppes 5d
Charter Communications 4
Chemtura 22a
Chesapeake Energy 9b
Chevron 9b
Chicago Mercantile Exchg. 11c
Children's Place 5d
Chiquita Brands Intl. 7b
Chubb 12
Church & Dwight 8a
Cigna 14b
Cincinnati Financial 12
Cintas 17
Circuit City Stores 5d
Cisco Systems 21a
CIT Group 11c
Citigroup 11c
Citizens Communs. 23a
CKE Restaurants 3a
Clear Channel Communs. 4
Clear Channel Outdoor 4
Clorox 8a
CMS Energy 24c
CNA Financial 12
Coach 2c
Coca-Cola 7a
Coca-Cola Enterprises 7a
Colgate-Palmolive 8a
Comcast 4
Comerica 10a
Commerce Bancorp 10a
Commerce Group 12
Commercial Metals 22d
Community Health Sys. 14b
Compass Bancshares 10a
Computer Sciences 19b
ConAgra Foods 7b
ConocoPhillips 9b
Conseco 12
Consol Energy 9b
Consolidated Edison 24c
Constellation Brands 7a
Constellation Energy 24e
Continental Airlines 18b
Convergys 19b
Con-way 18d
Cooper Industries 16d
Cooper Tire & Rubber 1a
Core-Mark Holding 5a
Corn Products Intl. 7b
Corning 21a
Costco Wholesale 6
Countrywide Finl. 10b
Coventry Health Care 14b
Crane 16f
Crosstex Energy 9b
Crown Holdings 22c
CSX 18d
Cummins 16f
CVS 6
Cytec Industries 22a

Alphabetical List of Companies

The number following each company name identifies the Scoreboard category under which it is listed

D

Dade Behring Hldgs. 14a
Danaher 16f
Darden Restaurants 3a
DaVita 14b
Dean Foods 7b
Deere 16f
Del Monte Foods 7b
Delek US Hldgs. 9b
Dell 21b
Delta Air Lines 18b
Deluxe 17
Dentsply Intl. 14a
Devon Energy 9b
Dick's Sporting Goods 5d
Diebold 21b
Dillard's 5c
DIRECTV Group 4
Disney (Walt) 4
Dollar General 5c
Dollar Thrifty Automotive 18d
Dollar Tree Stores 5c
Dominion Resources 24c
Domino's Pizza 3a
Donaldson 16f
Donnelley (R.R.) 17
Dover 16f
Dow Chemical 22a
Dow Jones 4
DRS Technologies 16a
DST Systems 19b
DTE Energy 24c
Duke Energy 24c
Dun & Bradstreet 17
DuPont 22a
DynCorp Intl. 16a
Dynegy 24e

E,F

E*Trade Finl. 11a
Eastman Chemical 22a
Eastman Kodak 2b
Eaton 16f
eBay 19a
EchoStar Communications 4
Ecolab 22a
Edison International 24a
Edwards (A.G.) 11a
EGL 18a
El Paso 9b
Electronic Arts 19c
Electronic Data Systems 19b
EMBARQ 23a
EMC 21b
Emcor Group 16c
Emergency Medical Svcs. 14b
Emerson Electric 16d
Energizer Holdings 8a
Energy East 24c
Entergy 24a
EOG Resources 9b
Equifax 17
Equity Office Properties 13a
Estee Lauder 8b
Everest Re Group 12
Exelon 24a
Expedia 5b
Expeditors Intl. 18a
Express Scripts 14b
ExpressJet Holdings 18b
Exxon Mobil 9b
Fairchild Semiconductor 20
Family Dollar Stores 5c
Fastenal 16g
Federated Dept. Stores 5c
FedEx 18a
Fidelity Natl. Finl. 12
Fidelity Natl. Info. 19b
Fifth Third Bancorp 10a
First American 12
First Data 19b
First Horizon Natl. 10a
FirstEnergy 24a
FIserv 19b
Fleetwood Ents. 1b
Flowers Foods 7b
Flowserve 16f
Fluor 16c
FMC 22a
FMC Technologies 9a
Foot Locker 5d
Ford Motor 1b
Forest Laboratories 15b
Fortune Brands 2a
FPL Group 24a
Franklin Resources 11a
Fred's 5c
Freeport-McMoRan C&G 22d
Freescale Semiconductor 20
Fresh Del Monte 7b
Frontier Oil 9b
Fuller (H.B.) 22a
Furniture Brands 2a

G,H,I

Gallagher (Arthur J.) 12
GameStop 5d
Gannett 4
Gap 5d
Gateway 21b
Genentech 15a
General Cable 16d
General Dynamics 16a
General Electric 16e
General Mills 7b
General Motors 1b
Genesis HealthCare 14b
Genuine Parts 5a
Genworth Financial 12
Genzyme General 15a
Georgia Gulf 22a
Giant Industries 9b
Gilead Sciences 15a
Gold Kist 7b
Goldman Sachs Group 11a
Goodman Global 16b
Goodrich 16a
Goodyear Tire & Rubber 1a
Google 19a
Grainger (W.W.) 16g
Granite Construction 16c
Great Plains Energy 24a
Greif 22c
Griffon 16b
Group 1 Automotive 5d
Guitar Center 5d
Halliburton 9a
Hanover Insurance 12
Harley-Davidson 1b
Harman International 2a
Harrah's Entertainment 3a
Harris 21a
Harsco 16f
Hartford Financial Svcs. 12
Hasbro 2b
Hawaiian Electric 24a
Health Management Assocs. 14b
Health Net 14b
Healthsouth 14b
Heinz (H.J.) 7b
Hercules 22a
Hershey 7b
Hess 9b
Hewitt Associates 19b
Hewlett-Packard 21b
Hillenbrand 14a
Hilton Hotels 3a
HNI 17
Holly 9b
Home Depot 5d
Honeywell Intl. 16a
Hormel Foods 7b
Horton (D.R.) 2a
Hospira 14a
Host Hotels & Resorts 13a
Hovnanian Ents. 2a
Hub Group 18a
Hubbell 16d
Hudson Highland 17
Humana 14b
Hunt (J.B.) 18d
Huntington Bancshares 10a
Huntsman 22a
IAC/InterActiveCorp 5b
IBM 21b
IDT 23a
IKON Office Solutions 17
Illinois Tool Works 16f
IMS Health 14c
IndyMac Bancorp 10b
Ingersoll-Rand 16f
Ingram Micro 21c
Insight Enterprises 21c
Intel 20
International Flavors 22a
International Game Tech. 3a
International Paper 22e
Interpublic Group 4
Intuit 19c
Invacare 14a
Iron Mountain 19b
ITT 16f

J,K,L

Jack in the Box 3a
Jacobs Engineering 16c
Jarden 2a
Jefferies Group 11a
JetBlue Airways 18b
JLG Industries 16f
Jo-Ann Stores 5d
Johnson & Johnson 15b
Johnson Controls 1a
Jones Apparel Group 2c
Joy Global 16f
JPMorgan Chase 11c
Kellogg 7b
Kellwood 2c
Kelly Services 17
Kennametal 16f
KeyCorp 10a
KeySpan 24c
Kimberly-Clark 8a
Kinder Morgan 9b
Kindred Healthcare 14b
King Pharm. 15b
Kohl's 5c
Kraft Foods 7b
Kroger 6
L-3 Communications 16a
Laboratory Corp. of America 14b
Laclede Group 24b
Laidlaw Intl. 18d
Lam Research 20
LandAmerica Financial 12
Landstar System 18d
Las Vegas Sands 3a
La-Z-Boy 2a
Lear 1a
Legg Mason 11a
Leggett & Platt 2a
Lehman Brothers Holdings 11a
Lennar 2a
Lennox International 16b
Level 3 Communs. 23a
Lexmark Intl. 21b
Liberty Capital 4
Liberty Global 4
LifePoint Hospitals 14b
Lilly (Eli) 15b
Limited Brands 5d
Lincoln Electric 16f
Lincoln National 12
Lithia Motors 5d
Live Nation 4
Liz Claiborne 2c
Lockheed Martin 16a
Loews 12
Longs Drug Stores 6
Louisiana-Pacific 22e
Lowe's 5d
LSI Logic 20
Lubrizol 22a
Lyondell 22a

M

M&T Bank 10a
M.D.C. Holdings 2a
Magellan Health Svcs. 14b
Manitowoc 16f
Manor Care 14b
Manpower 17
Marathon Oil 9b
Markel 12
Marriott Intl. 3a
Marsh & McLennan 12
Marshall & Ilsley 10a
Martin Marietta Materials 22b
Masco 16b
Massey Energy 9b
MasterCard 19b
Mattel 2b
Maxim Integrated Prods. 20
MBIA 12
McCormick 7b
McDermott Intl. 16e
McDonald's 3a
McGraw-Hill 4
McKesson 14b
MDU Resources Group 24c
MeadWestvaco 22e
Medco Health 14b
Medtronic 14a
Mellon Financial 11a
Men's Wearhouse 5d
Merck 15b
Mercury General 12
Meredith 4
Meritage Homes 2a
Merrill Lynch 11a
Metal Management 22d
MetLife 12
Mettler-Toledo Intl. 21c
MGIC Investment 10b
MGM Mirage 3a
Micron Technology 20
Microsoft 19c
Miller (Herman) 17
Mirant 24e
Modine Mfg. 1a
Mohawk Industries 2a
Molex 21c
Molina Healthcare 14b
Molson Coors Brewing 7a
Monsanto 22a
Moody's 11c
Morgan Stanley 11a
Mosaic 22a
Motorola 21a
MPS Group 19b
Murphy Oil 9b

N,O

Nabors Industries 9a
Nalco Holding 22a
National City 10a
National Fuel Gas 24b
National Oilwell Varco 9a
National Semicond. 20
Nationwide Financial Svcs. 12
NBTY 8b
NCR 21b
Network Appliance 21b
New Century Financial 13a
New Jersey Resources 24b
New York Times 4
Newell Rubbermaid 2a
Newfield Exploration 9b
Newmont Mining 22d
News Corp. 4
Nicor 24b
NII Holdings 23b
Nike 2c
NiSource 24c
Noble Energy 9b
Nordstrom 5c
Norfolk Southern 18d
Northeast Utilities 24a
Northern Trust 11a
Northrop Grumman 16a
NRG Energy 24e
NSTAR 24c
Nucor 22d
NVIDIA 20
NVR 2a
Occidental Pet. 9b
Odyssey Re Hldgs. 12
Office Depot 5d
OfficeMax 5d
OGE Energy 24c
Ohio Casualty 12
Oil States Intl. 9a
Old Republic Intl. 12
Olin 22a
Omnicare 14b
Omnicom Group 4
Oneok 24b
Oracle 19c
O'Reilly Automotive 5d
Oshkosh Truck 16f
Owens & Minor 14b
Owens-Illinois 22c

P

Paccar 16f
Pacer Intl. 18a
Packaging Corp. America 22c
Pactiv 22c
Pall 16f
Palm 21b
Pantry 6
Parker Hannifin 16f
PartnerRe 12
Patterson Cos. 14b
Patterson-UTI Energy 9a
Paychex 19b
Payless ShoeSource 5d
Peabody Energy 9b
Penney (J.C.) 5c
Pentair 16f
Peoples Energy 24b
Pep Boys 5d
Pepco Holdings 24a
Pepsi Bottling Group 7a
PepsiAmericas 7a
PepsiCo 7a
Performance Food 6
Perini 16c
PerkinElmer 15c
Perot Systems 19b
Petsmart 5d
Pfizer 15b
PG&E 24c
Phelps Dodge 22d
Phillips-Van Heusen 2c
Phoenix 12
Piedmont Natural Gas 24b
Pier 1 Imports 5d
Pilgrim's Pride 7b
Pinnacle West 24a
Pioneer Natural Res. 9b
Pitney Bowes 17
Plexus 21c
Plum Creek Timber 13a
PNC Financial Svcs. 10a
PNM Resources 24c
Polaris Industries 2b
Polo Ralph Lauren 2c
PolyOne 22a
Pool Corp. 2b
Popular 10a
Portland General Electric 24a
Potlatch 13a
PPG Industries 22a
PPL 24a
Praxair 22a
Precision Castparts 16a
Price (T. Rowe) 11a
Pride International 9a
Principal Financial Group 12
Procter & Gamble 8a
Progress Energy 24a
Progressive 12
Protective Life 12
Prudential Finl. 12
PSS World Medical 14b
Public Service Ent. 24c
Puget Energy 24c
Pulte Homes 2a

Q,R

Qualcomm 21a
Quanex 22d
Quanta Services 16c
Quest Diagnostics 14b
Questar 24b
Quiksilver 2c
Qwest Communs. 23a
RadioShack 5d
Ralcorp Holdings 7b
Raymond James Finl. 11a
Raytheon 16a
Realogy 13b
Regal Entertainment 4
Regal-Beloit 16d
Regions Financial 10a
Regis 3b
Reinsurance Group 12
Reliance Steel & Alum. 22d
Reliant Energy 24a
Rent-A-Center 5d
Republic Services 17
Retail Ventures 5c
Reynolds American 7c
Rite Aid 6
Robert Half International 17
Robinson (C.H.) 18a
Rock-Tenn 22c
Rockwell Automation 16d
Rockwell Collins 16a
Rockwood Hldngs. 22a
Rohm and Haas 22a
Roper Industries 16d
Ross Stores 5d
Royal Caribbean Cruises 3a
RPM Intl. 22a
Rush Enterprises 16g
Ryder System 18d
Ryerson 22d
Ryland Group 2a

S

Sabre Holdings 19b
Safeway 6
SAIC 17
Saks 5c
SanDisk 21b
Sara Lee 7b
Scana 24c
ScanSource 21c
Schein (Henry) 14b
Schering-Plough 15b
Schlumberger 9a
Schnitzer Steel Inds. 22d
Scholastic 4
Schulman (A.) 22a
Schwab (Charles) 11a
Scotts Miracle-Gro 22a
Scripps (E.W.) 4
Seagate Technology 21b
Sealed Air 22c
Sealy 2a
Sears Holdings 5c
Selective Insurance Group 12
Sempra Energy 24c
Service Corp. Intl. 3b
ServiceMaster 3b
Shaw Group 16c
Sherwin-Williams 5d
Sierra Pacific Resources 24a
Sigma-Aldrich 22a
Silgan Holdings 22c
Simon Property 13a
SkyWest 18b
SLM 11b
Smart & Final 6
Smith (A.O.) 16d
Smith International 9a
Smithfield Foods 7b
Smucker (J.M.) 7b
Smurfit-Stone Container 22c
Snap-on 2a
Solectron 21c
Sonic Automotive 5d
Sonoco Products 22c
Source Interlink 5a
Southern 24a
Southern Copper 22d
Southern Union 24b
Southwest Airlines 18b
Southwest Gas 24b
Sovereign Bancorp 10b
Spansion 20
Spartan Stores 6
Spectrum Brands 8a
Spherion 17
Sprint Nextel 23b
SPX 16f
St. Jude Medical 14a
St. Paul Travelers 12
StanCorp Financial Group 12
Standard Pacific 2a
Stanley Works 2a
Staples 5d
Starbucks 3a
Starwood Hotels & Resorts 3a
State Street 11a
Steel Dynamics 22d
Steelcase 17
Stein Mart 5d
Stryker 14a
Sun Microsystems 21b
Sunoco 9b
SunTrust Banks 10a
Superior Essex 16d
Supervalu 6
Swift Transportation 18d
Symantec 19c
Symbol Technologies 21c
SYNNEX 21c
Synovus Financial 10a
Sysco 6

T,U

Talbots 5d
Target 5c
TD Banknorth 10a
Tech Data 21c
Technical Olympic USA 2a
Teco Energy 24c
Teleflex 16e
Tellabs 21a
Temple-Inland 22c
Tenet Healthcare 14b
Tenneco 1a
Terex 16f
Tesoro 9b
Texas Instruments 20
Textron 16e
Thermo Fisher Scie
Thomas & Betts 16d
Thor Industries 1b
Thornburg Mortgag
3M 16e
Tiffany 5d
Timberland 2c
Time Warner 4
Timken 16f
TJX 5d
Toll Brothers 2a
Torchmark 12
Toro 16f
Total System Servic
Tractor Supply 5d
Transatlantic Holdi
Transocean 9a
Triad Hospitals 14b
Tribune 4
Trinity Industries 16
TRW Automotive 1a
TXU 24e
Tyco Intl. 16e
Tyson Foods 7b
U.S. Bancorp 10a
UAL 18b
UGI 24b
Union Pacific 18d
UnionBanCal 10a
Unisys 19b
United Auto Group
United Natural Foo
United Parcel Servi
United Rentals 16g
United States Steel
United Stationers 1
United Technologie
UnitedHealth Grou
Unitrin 12
Universal Forest Pr
Universal Health 1
Univision Commu
UnumProvident 12
URS 16c
US Airways Grp. 18
USEC 9b
USG 16b
UST 7c

V,W

Valero Energy 9b
Valspar 22a
Vectren 24c
Verizon Communi
VF 2c
Viacom 4
Vishay Intertechn
Visteon 1a
Volt Info. Sciences
Vulcan Materials 2
Wachovia 10a
Walgreen 6
Wal-Mart Stores 6
Walter Industries
Warnaco Group 2
Warner Music Gr
Washington Grou
Washington Mutu
Washington Post
Waste Manageme
Watsco 16g
Watson Pharmac
WCI Communitie
WellCare Health
WellPoint 14b
Wells Fargo 10a
Wendy's Intl. 3a
Werner Enterpris
WESCO Internati
Westar Energy 24
Western Digital 2
Western Refining
Western Union 19
Westlake Chemic
Weyerhaeuser 22
WGL Holdings 24
Whirlpool 2a
Whole Foods Ma
Williams 9b
Williams-Sonom
Windstream 23a
Wisconsin Energ
World Fuel Servi
Worthington Inds
WPS Resources
Wrigley (Wm.) Jr
Wyeth 15b
Wyndham World

X,Y,Z

Xcel Energy 24c
Xerox 21d
Xilinx 20
XL Capital 12
XTO Energy 9b
Yahoo 19a
YRC Worldwide
YUM! Brands 3a
Zale 5d
Zimmer Holding
Zions Bancorp

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t Allocation for -World Investors

ividual investor you likely expect your meet a variety of needs or goals. When nt professional determines what an ategy should be, a common practice is level of risk tolerance – a measure of the ility to handle declines in his or her is practice is based on modern portfo- d assumes that an investor has one, and el of risk tolerance. However, in review- tfolio, you may realize that you do not e investment goal or level of risk toler- may have many, relating to both your nger-term needs and goals. One of the goals of behavioral finance is to address that issue.

Your portfolio ought to be designed to satisfy an entire life cycle of needs. The basic needs of food, clothing, and shelter come first. Beyond that, you may want to consider your lifestyle, education, retirement, philanthropic and legacy goals. You should set aside specific money for each goal and invest each pool of money based upon your unique risk, return, liquidity, cash flow, and tax requirements for that goal. So when someone asks what your risk tolerance is, the answer ought to be, "That depends on which pool of assets you are asking about."

Traditional asset allocation optimization techniques are based upon optimizing a single risk/return relationship based upon a set asset/liability obligation. However, you may find that you require the optimization of multiple relationships. As an investor you may have multiple goals and different levels of risk tolerance and return requirements for different pools of wealth.

You and your investment professional can use a behavior finance approach to develop a comprehensive investment strategy to suit your individual financial needs and objectives. When applying this approach, you begin by determining the life span needs, or goals, that your portfolio must address and then allocate specific assets to satisfy each of those needs.

To read the full report, go to www.financial-resource.com/wellsfargo.asp

Wells Fargo Private Client Services offers a full range of financial services and products to help individuals and families build, manage, preserve and transfer their wealth. Teams of experienced local professionals advise clients on complex financial issues, and provide them with access to investment management, private banking, trust and estate, insurance and brokerage services provided through Wells Fargo Investments, LLC. Private Client Services oversees more than $204 billion in assets (9/06). 866-243-0931 • www.wellsfargo.com/investing/pcs

e for the Cookie Cutter Mold? re you Unique?

omer can have any color he wants so lack."

rd regarding the color of Model T's

hat whenever expensive luxury items ed for mass production it becomes the bottom line and less about the rience. For Henry Ford, the bottom ut getting people to buy his cars. For services industry the concept is the looks different -- it is about getting under management.

go investing in stocks and bonds was nly wealthy people did and as you might suspect they were very well catered to. However, since the advent of the IRA and the 401(k) plan, the percentage of people investing has risen dramatically. So the financial services industry has redesigned and mass produced Mutual Funds, Separately Managed Accounts (SMA's) and Variable Annuities. These products are sold in many shapes and sizes but the bottom line remains "getting assets under management" and "sacrifice personal service".

These are fine products but several studies have shown that the average investor during the mega bull market of the 1990's was lucky to out perform the market indexes. Why? The answer is that individual investors without the guidance of professional advice let their emotions and inexperience get the best of them and ultimately their investments didn't perform as well as they should.

Working with an independent fee based investment advisor shifts the focus from asset aggregation for the company's sake to financial well being of the individual investor. Independent advisors are free to focus on truly knowing their client and developing a relationship. This relationship is the key to long term financial success because when it comes time to make hard decisions you want to be consulting with a trusted advisor and not with a financial product merchant.

To read the full report, go to www.financial-resource.com/rss.asp

Rosenblum-Silverman-Sutton SF, Inc. RSS is a women owned independent registered investment advisor and has been serving clients for over 23 years. Their consistent investment style and focus on individual client needs has helped them build a successful business that clients have come to trust and depend upon. Every portfolio is customized from all equities to a balance of equities and fixed income because every client scenario is unique. Contact Michael Stephens at 1388 Sutter St. Ste 725 San Francisco, CA 94109. 415-771-2631 • www.RSSIC.com

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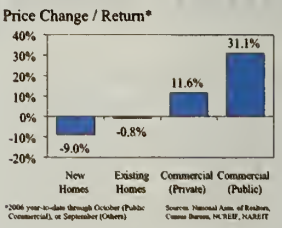
Differing Benefits – Housing and Investment Real Estate

Many individual investors and their advisors believe that they have a significant investment position in real estate, based solely on the value of their own home. Indeed, real estate comprises a major portion of household net worth in America. Residential real estate assets have grown from $6.6 to $20.3 trillion between 1990 and 2006, rising to 34% of all household assets and 77% of tangible assets. However, investors often blur the distinction between residential and commercial real estate, leaving a hole in their financial plans.

Differing supply–demand and investment cycles create major differences in real estate investment performance. The neighboring chart shows that home prices have declined during 2006, while commercial real estate returns remain positive. This indicates that the residential market has probably hit a relative peak, while several commercial sectors are just hitting their stride.

The investment natures of residential and commercial real estate are fundamentally different as well. Cash flow is a primary driver of investment returns for commercial real estate, providing investors with an income stream and a basis for property valuation. In contrast, residential price discovery is more subjective and less transparent, posing challenges for financial planning.

Commercial real estate ownership ca plished through a variety of vehicles dire men and of F The enal to c lios ent



ment objectives, and degrees of liquidit commercial real estate, investors enhan folios much more than through the sim of a home in a financial plan.

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ADELANTE
Capital Managemen

Adelante Capital Management LLC is an employee-owned registered investment advisor, dedicated to listed securities. Adelante's real estate focus and investment horizon has produced superior risk-adjusted returns for insti individual investors through a variety of investment vehicles since 1995. Adelante is one of the largest Hispanic controlled investment management firms in the United States. 510-986-2100 • www.adelantecapitalmanagement.c

Financial Independence – What is it and how do I get it?

Financial independence is knowing that your assets will provide you with a comfortable standard of living for the rest of your life. The word "comfortable" differs from person to person, for the sake of this discussion it is meant to convey one of the following:

1) The standard of living you have, or
2) The standard of living you wish to achieve, or
3) The standard of living you are willing to accept

Although most people wish to achieve financial independence, few have gone through the process of clearly defining the post tax cash flow needs necessary to achieve their goal. Proper planning and action now will get you on the right path and help to alleviate painful decisions down the road.

There are a minimum of six steps in the planning process that should be considered when defining how to achieve your own personal financial independence.

These are:

1) Define the goals for your desired lifestyle
2) Project expenses based on your lifestyle goals
3) Estimate after tax income from all sources
4) Determine if assets and income will be enough to cover expenses
5) Determine an appropriate asset allocation to achieve your goals
6) Adjust the items from above as needed until you have either reached your goal or h plan on how to attain it.

Many people, including financial pl the gun and focus solely on creating allocations and expected rates of re looking at the full lifestyle picture. Altl lio investing is an important step, it sho first or only step. The first task shoul your lifestyle goals. Do you want th have now or do you wish for a better

The most important step to maintain pendence is to continuously review y adjust for unanticipated expenses, fluctu tion rates or investment returns as these have a dramatic effect on your financial Attention now will help secure the futu

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t Selling As An Asset cation Tool

ng was once too exotic and dangerous al investors. And while most investors inue to avoid selling short individual are a number of short selling strategies reduce portfolio risk.

ple, today's investors can obtain short rough mutual funds or ETFs that sell a stocks or indexes short. By combining ed short exposure with their long equi- investors can create a hedged or even al portfolio. An actively managed short is able to limit losses in market rallies e long/short mix even more attractive.

But why would an individual investor deviate from a long-only buy and hold strategy?

Certainly investors would have benefited from short exposure during the 2000-2003 market downturn. But some indexes, including the widely following Dow, have gone on to all-time highs. Still, some short exposure may be appropriate for several types of investors. That includes equity investors who want a hedge against a sharp market correction. Others may think the rally off the 2003 bottom has run its course and want to prepare for a resumption of a bear market. Historically long bull markets are followed by long bear markets, and the bull market that ended in 2000 was one of the longest and strongest on record.

It's particularly important for new retirees to avoid losses. Negative returns early in the distribution period will cause savings to run out sooner than if losses are suffered prior to or well into retirement. As a result, new retirees may want to sell stock, or temporarily hedge against stock market losses. An explanation of this phenomenon is presented in online version of this article, along with reasons why we think the long bear market is long overdue.

The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The prospectus contains this and other important information about the investment company, and it may be obtained by calling 800.711.1848, or visiting www.prudentbear.com. Read it carefully before investing.

To read the full report, go to www.financial-resource.com/prudent.asp

ear Funds

Alternative investing with mutual funds. Please refer to the prospectus for special risks associated with investing in the Prudent Bear Funds, including, but not limited to, risks involved with short selling, futures contracts, options and restricted securities and investments in foreign and gold securities. Quasar Distributors, LLC, Distributor(11/06) The information provided herein represents the opinion of Prudent Bear Management and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

Widow and the Shoebox: utionary Tale for Surviving Spouses

and handled everything! He said, *Honey. When I die you'll be taken care* v that he's gone, I don't know if I'm out of money or not. All I have is a of papers. I don't know what half this lon't know what to do!" Mrs. T. – N.

n of what Tom Brokaw called "The eration" pass away, life with a shoe- ing a frequent reality for their wid- ans over the age of 60 now hold the ed wealth in history. During the s, the majority of that wealth will transfer to their statistically longer-lived wives. Traditionally, the husbands of this generation handled financial affairs. Some did a great job; others did not. In either instance, they often left spouses ill-equipped for their new financial role.

Sheila Odnert, an estate planner in Palo Alto, California, recalls one client's situation. "Mr. D. passed away a few years ago and by the time Mrs. D. came in, things were a mess." She had an unfunded trust, pension plan assets, multiple IRAs, children in financial crisis, and had even managed to lose sight of her dining room table under an ocean of papers. "It took 3 months just to get the title right on her stock certificates." Mrs. D got the help she needed before it was too late. Others are not so lucky.

"We help clients head off the "shoebox syndrome" by integrating continuous education on financial issues faced by surviving spouses, especially those affecting women. We want them to understand that we are here to help prepare and guide them in their new role. The worst partner to grief is confusion. By actively listening, analyzing, and planning, we eliminate at least some of the hardship of loss" explains Frank C. Weightman, Ph.D., financial planner in Memphis, TN.

Don't let yourself or a loved one become a "shoebox widow". Consult with a trusted, qualified estate planning specialist as soon as possible.

To read the full report, go to www.financial-resource.com/householder.asp

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BY ROBERT PARKER

'Tis the Season To be Bubbly

WINEMAKERS IN SPAIN, Italy, California, and even Australia make some pr fine bubbly. Still, nobody beats the sparklers from France's Champagne region. The best are from specific vintages—1990, 1995, 1996, and 2002 are a few. Many nonvintage champagnes (the "NV" on the label indicat it's a blend of several vintages) are wonderful, too, and come at far lowe prices. Champagne can be damaged by poor storage and bright in-stor lighting, so be sure to buy from a merchant with fresh inventory.

Best-Known Brands

Moët & Chandon

Its Dom Pérignon is unquestionably the world's most renowned champagne. The 1996 is legendary, and plan on spending $200—if you can find this 98-point beauty. The 1998 scores 92 points and should be easier to find.

Pol-Roger

Perhaps the best nonvintage brut in the marketplace is Pol-Roger, which runs less than $50. If you have $200 to spend, check out the flagship offering, the 1996 Cuvée Sir Winston Churchill.

Louis Roederer

Roederer's famed luxury champagne, Cristal, is said to be as popular among Mafia dons and drug kingpins as it is among wine connoisseurs. However, that shouldn't dissuade anybody from checking it out, especially if you are willing to spend $200-$250 per bottle. Roederer's more reasonably priced offerings ($30-$40) include their nonvintage brut and blancs de blanc.

Taittinger

An exquisite 100% chardonnay champagne, the Comtes de Champagne, is about as delicate and elegant as bubbly can be. The 1995 vintage, with ripe apple and pear scents, scores 96 points and will cost you about $175. Taittinger also produces a delicious nonvintage Brut for about $35.

Veuve-Clicquot

This house's expensive La Grande Dame is as good as it should be for the price (it runs from $65 to around $150, depending on the vintage). The nonvintage brut, at about $50, is topflight.

Lesser-Known Brands

Billecart-Salmon

While not a small house, this remains something of an insider's secret. The nonvintage brut is one of the best in th marketplace, at about $40. The real g here are the nonvintage brut rosé ($6 the vintage rosé champagne called Cr Elizabeth Salmon. The 1996 is exquisi points, $150).

Egly-Ouriet

Just about anything produced at this artisanal house is of impeccably high The nonvintage Brut Tradition Grand points, $50) produces scents of pear and toast.

Gaston Chiquet

A terrific champagne house producin good nonvintage and vintage blancs as well as a superb nonvintage Cuvée Réserve, usually priced under $50.

Visit **www.eRobertParker.com** for t Internet's most active wine bulletin tens of thousands of tasting notes, order his recent book, *The World's Wine Estates: A Modern Perspectiv* can also subscribe to Parker's news *The Wine Advocate*. Request a sam copy at: *The Wine Advocate*, P.O. B Monkton, MD 21111.

Wines rated from 96–100 are extraordinary; 90–95, excellent; 80–89, above average to very good. For more Parker picks, go to businessweek.c

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BY GENE G. MARCIAL

FORTUNE BRANDS MAY SPLIT OFF ITS JUICY LIQUOR BRANDS.

NEW WELLS ARE BUBBLING UP FOR AMERICAN OIL & GAS.

SHANDA INTERACTIVE LEADS THE PACK IN CHINESE NET GAME

Fortune's Spirits Rise

SHARES OF FORTUNE BRANDS (FO) have vaulted from 68 in June to 82.77 on Dec. 13 despite concerns that a housing slump might crimp 2007 earnings. Also seen as a drag is its "consumer conglomerate" image. Some 57% of sales come from home and hardware, 30% from liquor and wine, and 13% from golf gear. Formerly American Brands, the company spun off its Gallaher Group tobacco unit in 1994 and changed its name to Fortune Brands. Now some pros say Fortune may split in two. Spirits, led by No.1 bourbon Jim Beam, and golf, including Titleist golf balls and Footjoy golf shoes, will form one entity. Home and hardware, including Moen faucets, Therma-Tru fiberglass doors, and Master Lock, will be spun off to shareholders. A Fortune spokesman said the "breadth and balance of the company has delivered consistently strong results and shareholder value." But Mario Gabelli, whose firm owns 500,000 shares, says a split "is one way to unlock the value in the spirits operation." Gabelli figures the Street would give a pure spirits/wine entity a high price-earnings ratio equal to that of Constellation Brands or Brown-Forman. Gabelli says $3 of Fortune's estimated 2007 earnings of $5.75 a share comes from its spirits unit. Liquor accounts for 34% of profits, while home generates 56%, and golf 15%. Gabelli puts Fortune's intrinsic value at 110. Gregory Gieber of A.G. Edwards, who rates Fortune "buy/aggressive," says spirits "has a lot of upside potential" whose value isn't yet reflected in the stock. Fortune acquired 25 brands from Allied Domecq. last year. Gieber has a 12-month stock price target of 93.

GABELLI: UPBEAT

American Oil & Gas Hits Pay Dirt

WHEN AMERICAN OIL & GAS (AEZ) reported on Nov. 15 that test drilling at its Krejci well in the Powder River basin in Wyoming produced an average of 165 barrels of oil a day, the stock gushed from 6.35 to 7. By Nov. 30 it was nearly 8. It has since slid to 6.54. But the bulls expect it will bounce back up by yearend when the company updates results from the well, in which it has a 45% interest. David Lavigne of Edgewater Research Partners says AEZ "is progressing quite systematically on all three of its major projects" in Wyoming and North Dakota. But the "potential of the Krejci well, which also produced natural gas, has yet to be fully understood, he adds. Lavigne, who rates AEZ a "buy," with a 12-month target of 10, notes that 165 barrels a day at $60 apiece amounts to $3.6 million a year. Phil Dodge of Stanford Group also rates AEZ a "buy," and expects the stock to hit 10. It assumes a 20% success on more than 1,000 wells on the properties. Money manager BlackRock owns a 6.7% stake.

The Play's the Thing At Shanda Interactive

ONLINE GAMING IN CHINA is exploding, driven growth of Internet and broadband usage. In pa nongambling online action games involving mu players worldwide are expected to grow to 2.6 times cu levels by 2010, to a $1.8 billion business, says Tian X. H senior analyst at C.E. Unterberg, Towbin. She says Sha Shanda Interactive Entertainment (SNDA), China's larg developer and operator of such games, is "the best pure investment in the industry." Players don't pay to play, but they "buy" items such as virtual weapons or vehicles to use in the game. Shanda also derives revenues from ads in the games. The stock, which has bumped up from 13 in July to 19.87 on Dec. 13, will keep climbing, says Hou, because of the games' popularity and Shanda's rich pipeline of new products that will be out in 2007. In addition, notes Hou, Shanda's fundamentals are strong, with operating earnings poised to jump from $44 million in 2006 to $75.9 million in 200 to $96.8 million in 2008. Revenues are growing robus Hou sees profits rising from 26¢ a share in 2005 to 71¢ $1 in 2007, and $1.22 in 2008. Also bullish are Michael Brean Murray Carret and Dick Wei of J.P. Morgan Secu

BusinessWeek.com Gene Marcial's Inside Wall Street is post at businessweek.com/investor at 5 p.m. EST on the magazine' publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street firms hold positions in the stocks under discussion. Similarly, they have no in banking or other financial relationships with them.

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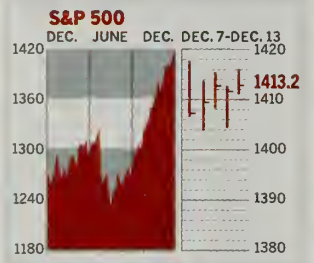
PersonalFinance | Figures of the Week

STOCKS



COMMENTARY

Disappointment that the Federal Reserve shows no intention of cutting interest rates anytime soon offset a solid employment report and better-than-expected retail sales. Shares of UAL and Continental took off on news of merger talks between the two airlines. Meanwhile Biomet jumped on reports that Smith & Nephew may want to buy the medical device maker.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	DEC. 13	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1413.2	0.0	13.2	11.5
Dow Jones Industrials	12,317.5	0.1	14.9	13.8
NASDAQ Composite	2432.4	-0.5	10.3	7.4
S&P MidCap 400	811.9	-0.9	10.0	8.8
S&P SmallCap 600	401.7	-1.1	14.5	11.6
DJ Wilshire 5000	14,189.3	-0.1	13.5	11.9

SECTORS

BusinessWeek 50*	800.4	-0.3	7.9	4.7
BW Info Tech 100**	444.5	-0.3	16.8	14.8
S&P/Citigroup Growth	653.1	-0.2	9.5	7.8
S&P/Citigroup Value	758.3	0.2	17.1	15.4
S&P Energy	467.6	0.6	25.4	20.8
S&P Financials	487.9	0.7	14.4	13.5
S&P REIT	200.4	-1.0	30.9	28.5
S&P Transportation	268.5	-1.9	7.5	10.4
S&P Utilities	187.8	0.7	17.6	15.9
GSTI Internet	204.0	0.5	-0.6	-3.4
PSE Technology	877.1	-1.3	4.9	2.5

*March 19, 1999=1000 **February 7, 2000=1000

GLOBAL MARKETS

	DEC. 13	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1972.6	1.5	30.5
London (FT-SE 100)	6192.5	1.7	10.2
Paris (CAC 40)	5475.9	2.3	16.
Frankfurt (DAX)	6520.8	2.4	20.6
Tokyo (NIKKEI 225)	16,692.9	2.0	3.1
Hong Kong (Hang Seng)	18,718.2	-1.6	25.8
Toronto (S&P/TSX Composite)	12,910.3	0.2	14.5
Mexico City (IPC)	25,690.4	0.3	44.

FUNDAMENTALS

	DEC. 12	WEEK AGO
S&P 500 Dividend Yield	1.76%	1.75%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.7	17.8
S&P 500 P/E Ratio (Next 12 mos.)*	15.3	15.3
First Call Earnings Revision*	-0.23%	-0.47%

TECHNICAL INDICATORS

	DEC. 12	WEEK AGO
S&P 500 200-day average	1310.2	1307.2
Stocks above 200-day average	75.0%	76.0%
Options: Put/call ratio	0.78	0.76
Insiders: Vickers NYSE Sell/buy ratio	6.75	6.40

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Divsfd. Metals & Mining	17.3	Steel	85.6
Homebuilding	15.2	Divsfd. Metals & Mining	48.3
Education Services	14.8	Broadcasting	41.3
Specialized REITs	9.9	Intgrd. Telecmms. Svcs.	38.1
Office REITs	9.9	Department Stores	36.3

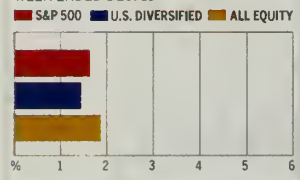
WORST-PERFORMING GROUPS

	LAST MONTH %	
Automobiles	-19.0	Education Services
Home Entertnmnt. Sftwre.	-9.9	Homebuilding
Electric Mfg. Svcs.	-7.1	Internet Software
Agricultural Products	-6.6	Internet Retailers
Health-Care Technology	-4.8	Health-Care Supplie

MUTUAL FUNDS

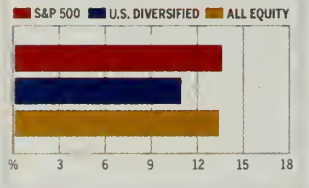
4-WEEK TOTAL RETURN

WEEK ENDED DEC. 13



52-WEEK TOTAL RETURN

WEEK ENDED DEC. 13



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Real Estate	5.0	Precious Metals	38.7
Latin America	5.0	Latin America	37.9
Natural Resources	4.6	Pacific/Asia ex-Japan	34.8
Precious Metals	4.1	Real Estate	32.5
LAGGARDS		LAGGARDS	
Technology	-0.3	Japan	1.1
Small-cap Blend	0.7	Health	4.6
Small-cap Growth	0.8	Large-cap Growth	5.4
Small-cap Value	1.1	Technology	5.7

EQUITY FUNDS

4-WEEK TOTAL REURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Legg Mason Eq. Tr. Bal. Prim	15.9	Oberweis China Opport.	78.0
Prasad Growth	10.4	Dreyfus Prem. Grtr. China A	73.1
DireXn. Cmdty. Bull 2X	10.3	ING Russia A	66.1
iShares MSCI Malaysia Idx.	9.3	U.S. Glbl. Invs. Prc. Mnls.	64.6
LAGGARDS		LAGGARDS	
Pacific Capital Mid Cap Y	-12.3	Ameritor Investment	-87.5
Principal Inv. MidCap Gr. I A	-10.5	DireXn. Emrg. Mkts. Short	-46.2
Pacific Capital Value A	-9.4	DireXn. Sm. Cap Bear 2.5X	-28.3
Third Millennium Russia A	-8.3	American Heritage Grth.	-25.0

INTEREST RATES

KEY RATES

	DEC. 13	WEEK AGO
Money Market Funds	4.85%	4.8
90-Day Treasury Bills	4.93	4.98
2-Year Treasury Notes	4.69	4.57
10-Year Treasury Notes	4.57	4.48
30-Year Treasury Bonds	4.68	4.6
30-Year Fixed Mortgage †	5.93	5.83

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND
General Obligations	3.67%
Taxable Equivalent	5.24
Insured Revenue Bonds	3.79
Taxable Equivalent	5.41

THE WEEK AHEAD

CURRENT ACCOUNT *Monday, Dec. 18, 8:30 a.m. EST* »The third-quarter current account deficit is expected to be $226.4 billion. That's the median forecast of economists surveyed by Action Economics. In the second quarter, the deficit was $218.4 billion.

PRODUCER PRICE INDEX *Tuesday, Dec. 19, 8:30 a.m. EST* »Producer prices probably bounced back with a 0.4% gain in November. In October the index fell 1.6%. Minus food and energy, producer prices likely climbed by 0.3%, following a 0.9% dip in the prior month.

RESIDENTIAL CONSTRUCTION *Tuesday, Dec. 19, 8:30 a.m. EST* » November housing starts are forecast to have edged back up to an annual rate of 1.55 million. Starts tumbled by 14.6%, to a rate 1.49 million, in October, the lowest level since July of 2000.

PERSONAL INCOME *Friday, Dec. 22, 8:30 a.m. EST* »Personal income most likely grew by 0.4% in November for a second straight month. Consumer spending probably picked up to a monthly rise of 0.4%, from 0.2% in October.

DURABLE GOODS ORDERS *Friday, Dec. 22, 8:30 a.m. EST* »Durable goods orders in November most likely improved 3.5%. New orders fell 8.2% in October as orders of civilian aircraft and computers fell by 44.6% and 37%, respectively.

The *BusinessWeek* produc climbed back to 284.6 for ended Dec. 2, a 7.7% gain year ago. Before calculatio four-week moving average index fell to 286.7.

BusinessWeek

For the BW50, more inve data, and the componer production index visit www.businessweek.com/extra

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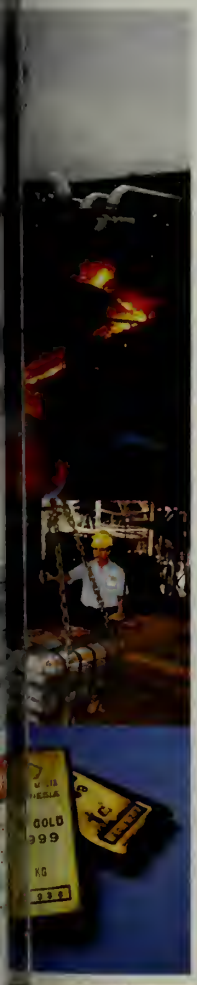
re proud to present our new logo which more accurately reflects where we are and where we are going. This change is part of the many exciting developments ening at Antam.

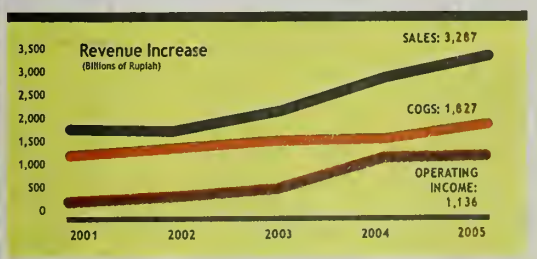


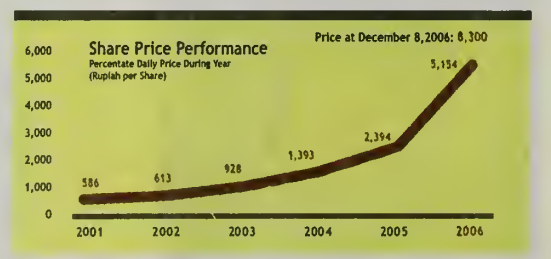
Our new logo is composed of three mountains, representing the rock/mineral source and diversity of Antam's products. The mountains themselves rise from an arc which represents nature with the reflection of the three mountains representing the mineral resources inside the earth. This logo represents a modern dynamic, environmentally responsible and community caring Antam. The symmetrical shape of the logo and the style of the logotype conveys a sense of harmony, stability, strength, and solidity, even friendliness. As well, the logo captures many of Antam's attributes such as mining, diversified, established, professional, prudent, trustworthy, progressive, dynamic and open.

Antam's President Director, D. Aditya Sumanagara said, "we trust our new logo will become a symbol of excellence in the mining and metals processing sector, for everyone from our customers and suppliers, to our local communities and to our shareholders"

We are a vertically-integrated diversified, financially sound, growth-oriented, mining and metals company with vast reserves spread throughout the mineral rich Indonesian archipelago. We are listed in Australia and Indonesia and our shareholders have come to know the value we can deliver, in terms of dividends, profit growth, wide margins and good returns. Our share price has outperformed similar companies and the Jakarta Composite Index for the past three years.

We are experts of mining and metals processing, are expanding our operations and should all go according to plan, we will make more money in 2006 and still more in 2007.





* "Mine Indonesia 2005", PricewaterhouseCoopers, 2006. The average net margin in 2004 was 15% for the Top 40 Global mining companies and 19% for Indonesian mining companies. The average return on equity in 2004 was 19% for the Top 40 Global mining companies and 27% for Indonesian mining companies. Antam did the Industry in terms of margins returns

Fully Listed in: Indonesia: (ANTM) / Australia (ATM). This communication is not an invitation to engage in, nor advice related to, any kind of investment activity. It is for information purposes only. Queries related to investment activities should be addressed to a licensed broker. Antam beat the industry in terms of margins and returns.

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Company Index

This index gives the starting page for a story or feature with a significa reference to a company. Most subsidiaries are indexed under their ow Companies listed only in tables are not included.

A
ABC (DIS) **80**
ABN AMRO (ABN) **30, 104**
Aéroports de Paris **16**
A.G. Edwards (AGE) **54, 56, 104, 150**
AIG (AIG) **26**
Airbus **87**
AirTran (AAI) **32**
Alcan (AL) **54**
Alcoa (AA) **54**
Al Frank Dividend Value (VALEX) **90**
Allegheny Technologies (ATI) **118**
AllianceBernstein (AB) **94**
Allied Domecq **150**
Alltel (AT) **72**
Altadis **78**
Altria (MO) **78**
Amazon.com (AMZN) **118**
AmBev (ABV) **86**
Ameren (AEE) **118**
American Century **16**
American Oil & Gas (AEZ) **150**
Ameriprise (AMP) **94**
Anadarko Petroleum (APC) **72**
ANSYS (ANSS) **60**
Apple (AAPL) **22, 24, 40, 104, 118**
aqualCE **14**
Artprice.com **116**
AT&T (T) **72**
Avon (AVP) **46, 86, 118**
Axle & Manufacturing (AXL) **110**

B
BAA **82**
Bain Capital **72**
Banco Itaú (ITU) **86**
Bang & Olufsen **40**
Bank of America (BAC) **34, 94**
Bankrate.com (RATE) **90, 94**
Barclays (BCS) **64**
Baring Asset **60**
Baxter (BAX) **42**
BellSouth (BLS) **72**
Bessemer Trust **54**
Best Buy (BBY) **60**
BHP Billiton (BHP) **34, 54**
Birinyi Associates **54**
BlackRock (BLK) **104, 150**
BlackRock Preferred Income (PSY) **90**
Blackstone **72**
Boeing (BA) **87, 118**
Bristol-Myers Squibb (BMY) **42**
Brown-Forman (BFB) **150**
BSkyB (NWS) **80**
BT (BT) **82**

C
Cabela's (CAB) **110**
Cabot Oil & Gas (COG) **72**
Cadbury Schweppes (CSG) **60**
Canaccord Adams **76**
Canon (CAJ) **87**
Capital Group **158**
Cartier **16**
Caterpillar (CAT) **104, 118**
Celgene (CELG) **118**
C.E. Unterberg, Towbin **150**
Charter (CHTR) **118**
Chase Growth (CHASX) **104**
Chase Home Mortgage (JPM) **37**
Cherry Creek Investment Advisors **94**
Chicago Board of Trade (BOT) **72**
Chicago Mercantile Exchange (CME) **72**
Chipotle Mexican Grill (CMG) **94**
Cingular **24, 40**
Cisco (CSCO) **104**
Citigroup (C) **32, 72, 86, 90**
Clear Channel (CCU) **72, 90**
Coca-Cola (KO) **32, 104**
Cohen & Steers International Realty (IRFIX) **94**
Coldwell Banker Redpath **114**
Color Kinetics (CLRK) **76**
Comcast (CMCSA) **80, 94**
Comerica (CMA) **64**
Commerzbank **82**
ConocoPhillips (COP) **104**
Constellation Brands (STZ) **150**
Continental (CAL) **32**
Credit Suisse First Boston (CSR) **87**
CVS (CVS) **78**

D
DaimlerChrysler (DCX) **60**
Dataram (DRAM) **90**
Deere & Co. (DE) **94**
Delta Air Lines **22, 32, 34**
Denso **87**
Deutsche Bank (DB) **87**
Deutsche Börse **72**
Deutsche Wohnen **82**
Diffusion Group **80**
Dodge & Cox (DODEX) **94**
Dow Chemical (DOW) **42**
Dow Jones (DJ) **46**
Dresdner Kleinwort **64**
Duane Reade **22**
DuPont (DD) **64**

E
Eastman Kodak (EK) **118**
Economy.com (MCO) **114**
Edgewater Research **150**
Electronic Arts (ERTS) **10, 118**
EMC (EMC) **72**
EMI **34**
Endesa **34**
Energy Conversion Devices (ENER) **76**
E.ON (EON) **34**
Equity Office Properties Trust (EOP) **72**
Ericsson (ERIC) **82**
EverBank **102**

F
Fairbanks Capital **37**
Fairholme (FAIRX) **94**
Fannie Me (FNM) **64**
Fidelity International Real Estate (FIREX) **94**
Fidelity Investments **16**
Forest Oil (FST) **72**
Fortune Brands (FO) **150**
Franklin Mutual Advisors (BEN) **78**
Franklin Templeton Hard Currency (ICPHX) **102**
Freeport-McMoRan (FCX) **34**
Freescale Semiconductor **72**
Fuel-Tech (FTEK) **76**

G
Gallaher (G
Gazprom 3
GE (GE) 94
General Ca
Genpact 10
Gimme Cre
GlaxoSmitl 60
Glenmede
Glenmede Value 54
Global Insi
GM (GM) 7
Gold Kist (
Goldman S 32, 34, 4 87, 114
Gol Linhas 86
Google (G 114, 118
Groupe Da

H
Halliburto
H&M 82
H&R Block
Harley-Da 118
Harris Ass
HCA 72
Hermès 16
Hess (HES
Hewlett-P 32, 72
High Freq Econom
Hodges (H
Honda (HI
HSBC (HE
Hyperion
Hyundai 3

I
IBM (IBM)
ICBC 84
IGN (NWS
Imperial T 78
Informati
ING (ING)
Innovatio
Innovatio
Intel (INT
iShares D Select D (DVY) 9
iShares S Growth

J
J. & W. Se

seas (JAOSX)
cco 78
tfolio(JENSX)
ties 80
Johnson
Chase (JPM)
82
PR) 80
ette & Woods
118
avis Roberts
(KFT) 78
T) 94
Servicing 37
ck Exchange
les 94
Napier Equity
04
il (MRO) 72
t Century
4
13, 110
l (MHP) 46
T) 42
urrency
102
n (MER) 54,
urhan Ford
ancial 64
ed Income
4
ent
ent 54
t (SFT) 10,
, 72, 90, 110
(MEH) 32
34
Group 110
(CO) 114
Stanley (MS)
82
Stanley Prime
ust (XPITX)
st (MORN)
(OT) 22, 72
24
m (NWS) 80
(NAQ) 32, 72
National City (NCC) 54, 114
Natura 86
NDS (NNDS) 80
Neiman Marcus 40
Nestlé (NSRGY) 42, 60, 78
Netgear (NTGR) 80
Neuromonics 14
New Amsterdam Partners 60
News Corp. (NWS) 80
New York Times (NYT) 26, 46
Nidec (NJ) 87
Nissan (NSANY) 39
Nokia (NOK) 40
Nomura (NMR) 87
Northwest Airlines (NWAC) 32, 34
Novartis (NVS) 60
NRG Energy (NRG) 34
Nuveen Investments (JNC) 104
NYSE (NYX) 72

O

Oak Associates 54
Oakmark International (OAKIX) 60
Oakmark Small-Cap International (OAKEX) 60
Ocwen Loan Servicing (OCN) 37
Oppenheimer (OPY) 80
Oracle (ORCL) 22

P

Pacific Ethanol (PEIX) 76
Pacific Growth Equities 76
Palm (PALM) 40
Panasonic (MC) 87
P & G (PG) 42, 78
Parlux Fragrances (PARL) 13
Pequot 60
Perry Ellis (PERY) 13
Pfizer (PFE) 90
Pharo Management 84
Phelps Dodge (PD) 34, 54
Phillips de Pury 116
Pilgrim's Pride (PPC) 34
Pioneer Cullen Fund (CVFCX) 78
Pioneer Investments 56
Plains Exploration & Production (PXP) 72
Prudent Global Income (PSAFX) 102
Prudential (PRU) 39
Putnam Equity Income (PEYAX) 90
Putnam Investments 54, 64

Q

Qualcomm (QCOM) 40
Quantum Fuel Systems Technologies (QTWW) 76
Quest Software (QSFT) 72

R

Reuters (RTRSY) 32
Rio Tinto (RTP) 54
Royal Dutch Shell (RDS) 32
Rydex Investments 102

S

Saffronart.com 116
Samsung 40
sanofi-aventis (SNY) 104
SAP (SAP) 22
Scania (SCV.A) 34
Schaeffer's Investment Research 110
Schlumberger (SLB) 60
Scottish Power (SPI) 82
Shanda Interactive (SNDA) 150
Sirius Satellite Radio (SIRI) 46
Skype (EBAY) 22
Smith Barney (C) 94
Sony (SNE) 10, 22, 118
Sony BMG Music Entertainment (SNE) 34
Sotheby's (BID) 116
Southern Copper (PCU) 118
Sprint Nextel (S) 24, 40, 72
Standard & Poor's (MHP) 72
Stanford Group 150
Starbucks (SBUX) 76
Strategas Research 60
Suntech Power (STP) 76
SunTrust (STI) 78
Swift Transportation 34
Symantec (SYMC) 22

T

Takeda Pharmaceutical 60
Tanglewood Capital Management 94
Target (TGT) 78
Telefónica (TEF) 86
Telesp 86
Templeton Global Bond (TPINX) 94
Texas Capital Value & Growth (TCVGX) 104
Thames Water 82
Third Avenue Value (TAVFX) 94
Thomas H. Lee Partners 72
Thomson (TOC) 72
Thornburg Investment Income Builder (TIBAX) 90
3M (MMM) 42
TippingSprung 16
T-Mobile (DT) 40
Toll Brothers (TOL) 60
Toray Industries 87
Toyota Motor (TM) 39, 76, 87, 110
Traffix (TRFX) 90
T. Rowe Price (TROW) 84, 87, 94
Tyson Foods (TSN) 34

U

UBS (UBS) 86
United Air Lines (UAUA) 32, 34
US Airways (LCC) 22, 32, 34
U.S. Bancorp (USB) 90
U.S. Cellular 72

V

Vanguard 90, 158
Vanguard Health Care (VGHCX) 94
Vanguard Information Technology (VGT) 94
VegaPlus Capital 84
Verizon (VZ) 24, 40, 72, 90
VIB Vermögen 82
VimpelCom (VIP) 84
Vodafone (VOD) 80, 82
Volkswagen 82

W

Wal-Mart (WMT) 18, 104, 164
Wall Street Access 72
Warner Music (WMG) 34
Washington Mutual (WM) 72
WaterBank 14
Wells Fargo (WFC) 16, 90
Wheeling-Pittsburgh Steel (WPSC) 34
William Blair Emerging Markets Growth 86
Winslow Green Growth (WGGFX) 76
Wm. Wrigley Jr. (WWY) 78
Wyeth (WYE) 104

X, Y

XM Satellite Radio (XMSR) 46
Yahoo! (YHOO) 118

Z

Zinifex 54
Zoltek (ZOLT) 76

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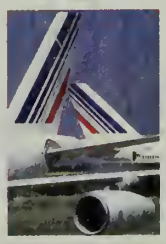


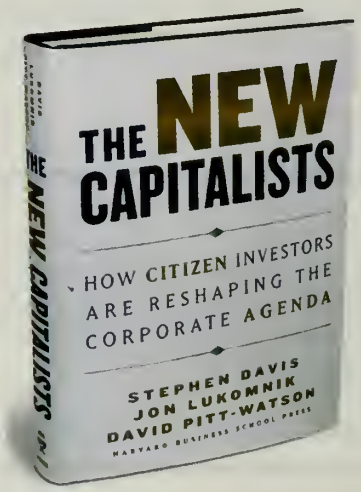
AIR FRANCE

Financial Power to the People

THE NEW CAPITALISTS How Citizen Investors Are Reshaping the Corporate Agenda
By Stephen Davis, Jon Lukomnik, and David Pitt-Watson; Harvard Business School; 288pp; $29.95

It wasn't too long ago that a handful of men controlled the purse strings of U.S. capitalism. Wealthier than entire nations, crusty oligarchs like John Pierpont Morgan and John D. Rockefeller exerted all-but-complete influence over the financial landscape, unabashedly looking out for Number One.

A century later, in the age of the 401(k), that clout has been dispersed into the accounts of hundreds of millions of everyday shareholders. This is a shift that Stephen Davis, Jon Lukomnik, and David Pitt-Watson chronicle and applaud in *The New Capitalists: How Citizen Investors Are Reshaping the Corporate Agenda*. "The power to sway whole nations' economic fortunes," write the authors, "is now held by those institutional investors representing policemen, auto workers, and computer programmers saving for retirement. The premise of this book is that this change has been revolutionary."



True. The corporate boardroom is, more than ever, in the employ of a company's majority owners: financial institutions such as Vanguard and American Funds that invest trillions on behalf of the little guy. The book's authors—corporate-governance gurus with significant asset-management experience—detail what they observe as a contagious spirit of accountability. Readers might be inspired to grab the mike at an annual meeting and scream: "I am shareholder. Hear me roar!" The book is thorough and loyal to doing the right thing—for which it should be commended. But for all their thoughtfulness and careful research, the authors get too caught up in cheerleading for an ideal "civil economy." As a result, they understate frustrating realities.

The writers demonstrate how shareholder accountability can matter. Citing a target list of governance laggards, they show how activists helped create returns of 11.6% above the market—$40 billion in "'found money' [that] would have stayed hidden had owners remained quiescent." When the $172 billion California Public Employees' Retirement System (CalPERS) stated that the Philippines was neither transparent nor accountable enough for its pension-investing standards, the Manila Stock Index plunged 3.3% in a single day. Many more examples and attendant lessons for "new capitalist" shareholders and managers follow.

Problem is, the authors believe it's almost a fait accompli that investors are ready to build a shining city from today's Potemkin shareholder democracy. In fact, companies routinely undermine shareholder power by staggering elections. They shower executives with repriced or bac options and supersize pay even as general shareholde poor returns. And executives still hide behind dual sha classes. The authors say this is all changing: "The abr of accountability between directors and owners has be cancer at the center of corporate legitimacy. Fortunate a cancer that is beginning to yield to treatment."

That is an overly hopeful prognosis. Yes, companies more attuned to the priorities of their shareholders. B authors fail to underscore a parallel A soaring number of companies are opting out—by going private and lar removing themselves from the scruti of analysts, governance referees, and financial press. Other companies are their shares overseas, where regulati aren't as onerous. Get a few drinks i average 2006 CEO, and he will tell y running a U.S.-listed public compan increasingly not worth the hassle.

The New Capitalists would have be from more appreciation of the fact th executives and boards are not glutton punishment. They don't enjoy having footnote of their compensation packa scrutinized. Ditto fund managers, m of whom earn a good living by cranki out market-average retur (The writers concede the industry's conflicts and sh mindset.) Few in either ca are driven by civic obligati They want prestige, mone influence—and to be left a And the individual invest looking for more homewo the authors also admit).

> Yes, investors have more clout. But companies are escaping scrutiny by going private

Yet the writers neverth prescribe more heavy lifti They urge companies to separate chairmen and C and to flesh out financials implore fund managers to be more active, analysts to unconflicted, and investors to scrutinize fees. Each of seems, should drink more milk and do extra push-up

The New Capitalists is a fine, richly reported accou things do and should work in a very imperfect shareh democracy. But the authors' idealism gets in the way. money, our companies, our choice" is the book's clos Chase it down with a spoonful of salt. ■

–By Robe

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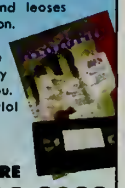

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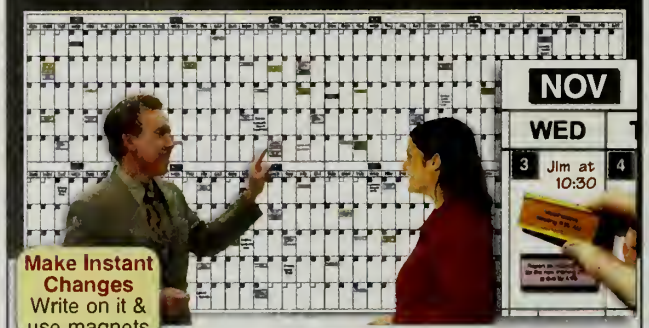

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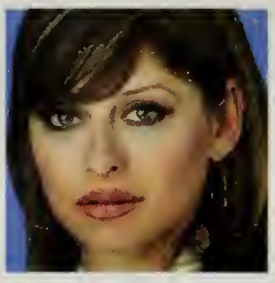

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WITH **MARIA BARTIROMO**

Hank Paulson on China And the Year Ahead

TREASURY SECRETARY Hank Paulson traveled to China on Dec. 12 for his first strategic meeting with his Chinese counterparts. He arrived in Beijing with a briefcase full of issues, including a weakened dollar and a mind-boggling trade deficit. I caught up with him before he left to talk currencies and competition.

I have in front of me, Mr. Secretary, 20 bills that are basically anti-Chinese measures from the incoming Congress. Are they sensing a new hostility in China from the Democratic majority?
I don't know what they're sensing in China and what they're not sensing. But I do know...that there is a growing protectionist sentiment not only in this country but in China and all around the world. It's a paradox, because the lesson of the past 25 years has been that those economies that have opened themselves up to competition, reform, and integration into the global economy have benefited, while the rest have been left behind.

How long is the Administration going to give the Chinese to put the changes in place that you are looking for, whether on currency, trade, or opening up markets to foreign companies?
A big part of the strategic economic dialogue will be to persuade the Chinese to accelerate the pace of their reform. When we talk about reform with the Chinese, there's total agreement in terms of what they need to do...so the debate is about timing. The case we're making is that there's more risk in going too slow than in going too fast, and that they need to speed up the pace of the reforms because...they're somewhere between a market-driven economy and [a managed economy]...and that'll get them nowhere. If China were a small country, it might be easier for them to say, "You know, we're in transition. Give us more time." But it's a global economic leader, and the rest of the world isn't going to give China a lot more time.

What would be the right way for China to adjust its currency?
They need a currency whose value is set by the competitive marketplace. That's what every other major participant in the economic system has. And China is unable to do that now and will be unable to do it until it opens up its capital markets...to competition and foreign investment.

Let me ask you about hedge funds. We've got 9,000 h funds managing some $1.3 trillion. Are you more wor about the leverage at hedge funds or the exposure th banks and brokers [bankrolling them] have?
The whole hedge fund area is something that is bei at very carefully...by the President's working group me, Ben Bernanke from the Fed, Chris Cox from the Reuben Jeffery from the CFTC. There have been maj in capital markets over the past 5 to 10 years. And or changes has been big increases in private pools of we think about this, we need to come at it from a r different perspectives. One is investor protection, something Chris Cox is very focused on. [We've go sure] we've got enough liquidity in the system, eno parency between the hedge funds and those regulat that are lending them money. But by and large, h derivatives have been positive for the capital market made them more efficient, more liquid, and been ve in dispersing risk. That may be one of the reasons had a financial shock in the past eight years.

I was just in London, and people were talking about l becoming the new financial capital of the world. Do y that happening?
I see pretty clearly that New York is the financial the world and...the center of innovation. But Londo vibrant financial center. What they've accomplishe been very good for London and very good for the w

Do you think London has weakened its standards?
I didn't say London had weakened its standards that the U.S. played the major role in moving quick up after the financial scandals...and the rest of the benefited. The question now in the U.S. is how do we get the balance right? How do we recalibrate? I spend a lot of time thinking about it, the President's working group is thinking about it, and... Chris Cox is making a major move in terms of how...Sarbanes-Oxley is going to be implemented.

Income inequality in this country is getting dramatically worse. What can be done to fix this?

rend that has been going on for over 20 years. I think y attributable to a greater integration of the global an increase in unskilled labor globally, and technol- e going to have to think more creatively about how to some of the dislocations that we're seeing and work on this problem.

mean a minimum wage hike?

ink the minimum wage, in and of itself, is going to be term answer. But clearly this Administration is sup- a minimum wage hike that's structured properly.

Bush has suggested that he wants to revisit Social eform again in the next two years. Has he asked you at effort or be part of that?

l Security reform, entitlement reform overall, is a ma- or the President. The sooner we fix it, the less costly the more economic flexibility we will have, and the ill be to the younger generation.

ation a must-have in any reform?

want to condition the discussion. The believes strongly that personal accounts portant part of this puzzle. And I see it that way, too. But the Democrats can come to the table and talk about their alternatives. What I want to do is get reasonable people together and come up with something that works.

What are the most pressing economic priorities for 2007?

I have to say energy security is a very important issue for this economy. We are too dependent upon oil—much of it foreign oil, and much of that from troubled places around the globe. And so we need to do more to invest in alternative fuels, renewable fuels, cleaner fuels. That will ultimately lead to cleaner air, cleaner water, and more diversity of our energy sources. We've talked about entitlement reform. Again, very, very important. Then, of course, we need to be vigilant and keep our capital markets competitive because capital markets are the foundation of our economic strength...and prosperity over the long term.

Do you think, as Wall Street's recent behavior seems to suggest, that the housing slump has bottomed out?

I don't know whether it has bottomed out. The one thing I do believe is that we've had a correction that in many ways was inevitable and necessary. And I'm feeling good about where we are in the economy right now. The housing correction has taken about 1 percentage point off of GDP, so we're growing below our sustainable rate right now. But the economy is diverse and strong. We've got a service sector that's very strong, the consumer is still very solid, the corporate sector is strong. So whether [housing] has bottomed out, not quite bottomed out, or is going to take a quarter or two longer, the thing that we've seen is that other parts of the economy are doing so well that we're just powering through this.

"There is a growing protectionist sentiment... in China and all around the world"

As part of that strength, we've got incredible amounts of money moving into private equity. Do you worry that a bubble is developing?

No, I'm not worried about a bubble. We have a very strong stock market [that's] at record levels. But it's getting there the good way. When you look at multiples of earnings today relative to what they were in the late '90s, this is a solid market. And I think one of the real positives we've seen is that this has added to the consumer's net worth. Consumers have felt the benefit of [the strong market] through their 401(k) accounts, and this has more than offset the slowdown in the retail housing market. ■

Maria Bartiromo is the anchor of CNBC's Closing Bell.

STAN HONDA/AFP/GETTY IMAGES

IdeasTheWelchWay

BY JACK AND SUZY WELCH

The Boardroom Bunker

Do you think boards today are running better or worse than before?

—Anonymous, Phoenix

Actually, too many of them are running scared. And while that may give some governance groups a self-satisfied twinge of victory, a board in defensive mode is bad for employees, companies, and the economy.

So what's going on? We've been speaking recently with groups of CEOs—a total of about 300—in several small, in-depth sessions. They have come from a variety of companies, but one thing they all share, to varying degrees, is a pressing concern about the changed nature of their boards, a direct result of the governance scandals and the reforms that followed. As one CEO put it: "Every meeting starts in one form or another with the question, 'Has anything happened since we last met that's going to show up in the papers and embarrass us?' Then we hunker down over financial reports and risk assessments to give everyone a sense of comfort."

Now, a board getting a strong dose of comfort is fine. Boards have to feel confident that companies are abiding by the spirit and letter of the law. No one wants another WorldCom or Enron to erupt, let alone responsibility for it.

> Too often the question is: 'Has anything happened lately that could embarrass us?'

But hunkering down over numbers and downside scenarios is just not what boards should be doing with all their time. Compliance doesn't happen because a group of overextended, far-flung executives flies in 10 times a year to examine the books. Compliance happens because control systems are carefully monitored by internal managers, who are understandably in a state of hyperawareness.

Control systems today are also being monitored by newly energized outside accountants. Ironic, isn't it? The same accountants who failed to flag the scandals are now the biggest beneficiaries. All those additional billed hours for extra, extra due diligence! Regardless, accounting data have never been more meticulously scrutinized.

Which should free boards to do their real work—developing a healthy dialogue with management about building a better future, together asking "How big can we get?" and "How fast can it happen?" After all, who wins if a company has no growth? Not employees, who don't get the opportunity to improve their lives with better jobs and careers. No shareholders, who don't get the equity appreciation fr successful acquisitions or the payback from daring or growth initiatives. And not communities, who don't g extra tax revenue from thriving companies, new and c

IMPORTANTLY, WIDE-RANGING DEBATE about growth ar can happen only in an atmosphere of sharing and trus why we're so opposed to the recent push by some acti shareholder groups to change SEC rules for electing d which would open the door to the possibility of board with special-interest "representatives." Just imagine t organizers who are taking the anti-Wal-Mart campaig national level sitting in the boardroom in Bentonville. What a disaster! We guarantee there wouldn't be muc debate about the inevitable crises of management, let growth opportunities, in that war zone.

No, constructive dialogue occurs only when a boar comprised of savvy leaders and experienced entrepre uses its wisdom, character, courage, common sense, collective judgment to help the CEO and top team ge right answer. Of course, the board must assess and cl management. It must get out of headquarters to see i employees in the field are really carrying out the mis and hewing to the values that the brass espouses in t boardroom. But ultimately, a board and managemen play on the same team, not operate at cross-purpose

There's just not enough of that happening now. Di are too paranoid. Which is why change—and change imperative—must be led by CEOs themselves. Natura of them are paranoid, too, in this era of tenuous tenu for the current impasse to break, CEOs must have the confidence to put themselves on the line with a comm to their boards that controls are fully functioning. Th earn and demand broad trust, and the board must gi put the right CEO in place. With that dynamic, board let go of their crippling fear. And together, the CEO ar director can set a new tone and create a new agenda, Item 1 deals with any financial (or other) bumps ahea Items 2 through 10 concern exciting strategic objecti

To your question, then, boards today are running but only for cover. To run better for the sake of empl shareholders, and communities, they need to climb bunker and get back to the business of the future. ■

Jack and Suzy Welch look forward to answering your ques about business, company, or career challenges. Please e-m them at **thewelchway@businessweek.com.** *For their w podcast, go to www.businessweek.com/search/podcasting.*

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